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The U.K. Economy 1951-61: Performance and Prospect

By Graham Hutton

THIS seems a good moment to appraise Britain's economic performance in the past decade and her prospects in the rest of the 'sixties. The Budget of 1961 marked a departure from other post-war budgets. The post-war system of settlement of international payments under the I.M.F. suffered its first real check early this year. Something must obviously be settled, one way or another, about the Six and the Seven. And in mutual defence, diplomacy, lending for the industrialization of the less-industrialized countries of Africa, Asia and Latin America, and the application of technical discovery in business, the new and vigorous American Administration has taken—unchallenged by anyone in Western Europe—the leadership of the free world. We stand, Russians along with us, on a chronological watershed, before new vistas, with the old familiar views at our back.

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Anyone who can rest content with Britain's economic performance in the '50's, compared with those of the other leading industrial nations, must have set his sights desperately low in the late 1940's. Since so much special pleading, exculpation of particular groups or interests, and urging of extenuating circumstances always bedevils analysis of our economic performance, it is advisable to take the argument in stages.

Let us begin with what is of prime importance to the British standard of living: exports of manufactures. With these, overwhelmingly, we buy the imports of four-fifths of all raw materials used by industry, and half of our food and feedingstuffs. Moreover, vital as are our overseas investment income and invisible exports—now they only buy one twenty-fifth of our imports whereas before the war they bought one-fifth—we are far more dependent on exporting our

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manufactures than ever before. We have lost coal, and most cotton textiles, as exports. We have to import more of many basic and semi-manufactured things as "feedstock" for our newer industries—not only oil but also new ores, metals, chemicals, materials for paper or packaging, synthetics, etc. Our people spend far more per head (and rightly so) on foods than before the war. They are clothed, shod, housed better. They drink and smoke more per head; so much so that few Britons realize even yet—despite the small and slow de-control of house-rents for the average and lower income-earners—that the nation is spending 40 per cent. more on alcohol and smoking in a year than it spends on all housing, rates, water and housing maintenance. And that ratio isn't accounted for by the rich, who spend relatively far more on housing and far less on alcohol and tobacco.

CHANGING TERMS OF TRADE

We could not possibly have allowed our people so high a standard of life, based on soaring imports of things for producers and consumers, had it not been for the fall in the prices of basic foodstuffs and a few industrial raw materials since 1956, and our imports of capital.

The terms of trade—how much of her vital imports she can buy for a given value of her exports—play a bigger rôle in Britain's balance of payments than most pundits (let alone ordinary folk) realize. For example, most pundits would be surprised to learn that if you express U.K. export prices as a percentage of import prices and take the ratio in 1938 as equivalent to 100 the changes in the terms of trade have been as shown in the table opposite.

It is hard to understand, in the light of these big swings in

COMPOSITION OF UNITED KINGDOM TRADE

Exports	1935–38	1954	1960
	%	%	%
Engineering products	20·1	37·9	44·5
Metals	13·4	12·8	13·3
Textiles	24·0	13·5	8·5
Chemicals	6·3	7·7	9·0
Other manufactures	11·9	10·9	10·7
Coal, coke, etc.	8·0	2·5	0·8
Other exports	16·3	14·7	13·2
	100·0	100·0	100·0

Imports	1935–38	1954	1960
	%	%	%
Food, beverages, tobacco	44·9	39·1	33·9
Basic materials	27·9	30·2	23·3
Mineral fuels, lubricants	4·8	9·8	10·6
Manufactures for processing	15·1	15·3	19·9
Finished manufactures	6·7	5·1	11·9
Other imports	0·6	0·4	0·4
	100·0	100·0	100·0

U.K. TERMS OF TRADE, 1938 = 100

1913	70	before the first world war Britain paid dearly for imports;
1921	99	effect of the war was to enable Britain to buy more imports for the same value of exports owing to the post-war slump;
1925–28	83	effect of world economic recovery was to make Britain pay more for her imports, by exporting more for the same volume of imports;
1933	104	the Great Depression in world prices hit raw materials and foods more than manufactures; so Britain could buy 104 units of imports with the same amount of her exports as bought only 83 in 1925–28;
1946	92	immediately after the second world war her terms of trade had turned against her again, but only by roughly 8 per cent. since 1938;
1951	72	the Berlin airlift and Korean war had driven world prices of foods and materials to their all-time peak; so Britain's terms of trade were as bad as they had been in 1913. She had to export much more (nearly 40 per cent. more) "valued added" cr work done in her manufactures to get the same amount of her vital imports as in 1938;
1960	94	but owing to expanded productive capacity for foods and raw materials in the world after 1951, the peaceful aftermath of the Korean war, and a couple of slight recessions in the U.S.A., the world price level of primary products fell steadily from 1956–57, while the prices of manufactures stayed stable or went on rising. So Britain's terms of trade improved by nearly 30 per cent.—in fact to the best ratio since 1938.

comparatively short spans of years, why many British authorities—indeed, many economists—ignore or pooh-pooh the effects of changes in our terms of trade.

The optimistic observer, after seeing these figures, says: the Korean war was abnormal, an accident, not a regular incident: Americans aggravated the situation by strategic stockpiling; the world got to its post-war economic norms in the second half of the 'fifties; so—such accidents as the Korean war apart—the 1960 terms of trade for Britain can be counted on to endure. The world's capacity to export foods and raw materials is enormously bigger than it was a decade ago (when Korea took everyone by surprise). Britain's terms of trade in 1960 were still roughly 10 per cent. *less* favourable —she had to export roughly 10 per cent. more of her people's

work in "value added" to import the same amount of their vital supplies—than in 1933. But that was a generation ago and in the Great Depression, when Britain had 3,000,000 unemployed—compared with our average since 1948 of only 300,000. More important is it (says our optimist) to note that our terms of trade are only about 6 per cent. less favourable than in 1938, about 13 per cent. *more* favourable than in the 'twenties and 33 per cent. more favourable than nearly half a century ago in 1913.

Our optimist concludes this way: Britain's terms of trade may even worsen again, as the U.S. economy forges ahead with those of the Six in Europe, and with fresh financing of under-developed countries' capital development programmes, etc.; all of which activity must pull the average of prices for primary products nearer to their level in, say, 1956. But if that occurs, Britain will, as usual, gain on the swings what she loses on the roundabouts. Her less-industrialized suppliers of primary products will earn more in convertible currencies from their revived exports. These countries, who are also largely her customers, will then buy *more* (a greater volume of manufactures) from Britain at the ruling sterling prices.

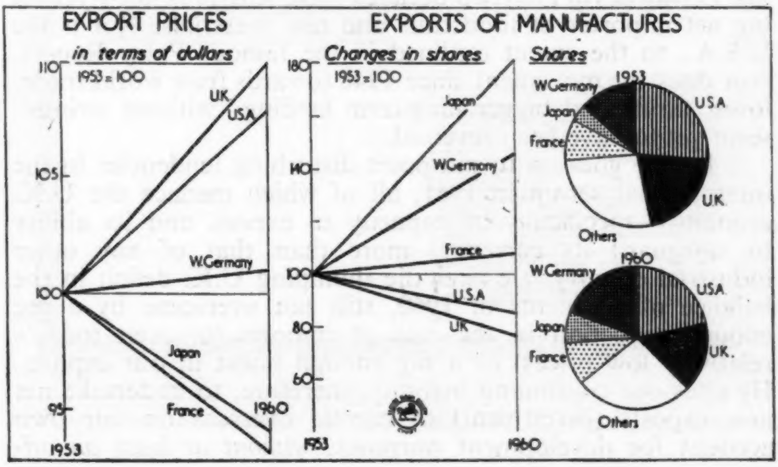
True, we may have to send abroad more of our people's work, the sterling value they have added by their labour (of all kinds) to our prior imports of food and raw materials. But we shall run nearer to our productive capacity. The more we *have* to export "unrequited" (because the terms of trade turned against us) will only be a small portion of the much bigger "more" we shall be *requited* to export, anyway. We shall in fact earn extra moneys, paid on balance to us for exporting a bigger *volume* of our manufactures, and paid out of the less-developed countries' extra earnings from all buyers of primary products in the world. Clinching his conclusion, our optimist asks: Which do you prefer? Being in a Great Depression as in 1933; sharing heavily in the world's unemployment of human and other resources; but buying your food cheap enough to keep millions of unemployed on the dole? Or terms of trade less favourable, but everyone fully employed everywhere?

THE PESSIMIST'S CASE

Alas, if only it were that simple! Let us listen to the pessimist: the member of "the awkward squad". He has hitherto been like "a chield amang you taking notes" all the time. He is a nasty, mean-minded, spoil-sport who likes asking

barbed questions. First he agrees on the facts; only he takes all the nice optimistic gloss from them; like this. In 1956–61 the turn in the terms of trade in our favour was equivalent to a *gratis* 12 per cent. rise in the volume of our imports, unrequited by any extra exports for it from us. What did we do with it? Our exports have only slightly risen since 1957. The optimist said: that's *because of* the slump in our primary-products-exporting customers' earnings, which turned the terms of trade our way. If he's right, why has the *share* of world trade in manufactures of the U.K. alone, and without a halt, gone down not only since 1953, as shown in the diagram below, but all the time since 1950? The U.K. *share* of trade in overseas markets for manufactures went down when there was a runaway Korean boom or a slump in the price level for foods and materials; when only the U.S. was in a recession and when it was booming. It is the only industrial country to show such strange consistency. Not even the U.S.A. shows it.

Very well; if the U.K. always gains from the swings in world trade what it loses on the roundabouts, where is its net gain in exports over the decade 1951–61, since the German and Japanese recovery was assured? Where is it, even, since 1956, when Germany and Japan faced the same problems of trading and overseas markets as the U.K.? Moreover, that optimist is out of date. For the last two years both the U.K. *and* the rest of the Sterling Area have run deficits in their balances of trade and payments with the outside world. "Things ain't what they used to be" when rising prices for

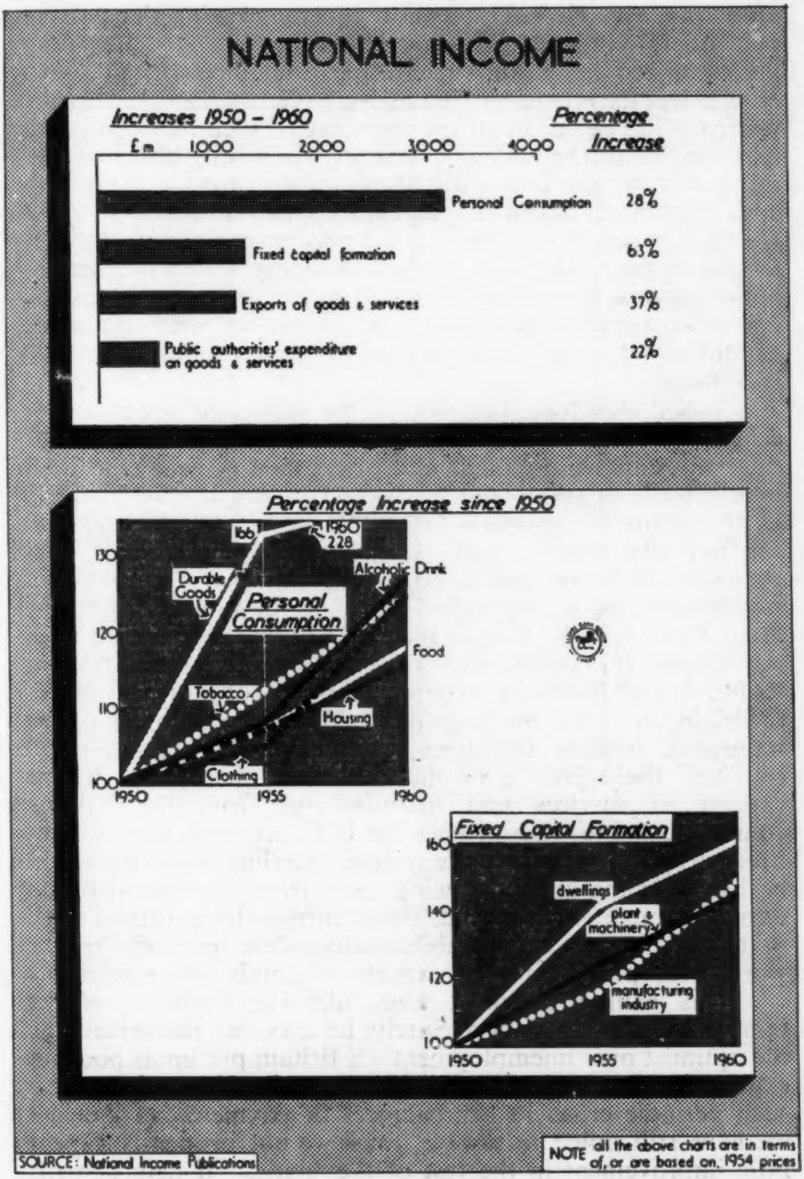


primary products earned a surplus for the R.S.A. wherewith to offset the U.K.'s deficits, or *vice versa*. And this has been caused by the R.S.A. steadily tending to buy more and more of its imported manufactures *away from* the U.K., thus aggravating "runs" on sterling whenever the U.K. and the R.S.A. simultaneously are in deficit.

The pessimist next says: Were it not for the economic misfortune of our suppliers abroad, we would have had a far more thumping deficit in our 1960 balance of payments. We would have had to pay something of the order of £400–£500 millions more for the same volume of imports, or reimpose import controls. We would have shown a turn-around in our balance of payments between that of 1959 and that of 1960 of nearly £1,000 millions, within 12–18 months. We could not possibly have let our people—firms and individuals—enjoy such a domestic boom as they did. They could only do it—to a large extent they are still only doing it—with so poor a showing of exports, because of that decline in world prices for foods and raw materials. If that reverses itself, look out for sudden and severe squalls. Through them the booming U.K. home market, and sterling itself, will have to beat. It won't be able to weather them if it carries as much sail, as much top-hamper, as it has carried for the past few years: heavier defence spending abroad, heavier overseas investment, offset only by imports of long-term and short-term capital.

The discomfiting pessimist freely admits that, contrary to his and a few others' expectations (see Mr. Colin Clark's *The Economics of 1960* two decades ago), Russia is not—yet—a big net importer of foodstuffs and raw materials. Nor is the U.S.A., to the extent outlined in the famous Paley Report. Nor does the movement since 1948 towards freer world trade, lower tariffs and bigger long-term lending "without strings" seem yet to have been reversed.

But he goes on to pin-point disturbing tendencies in the international set-up in 1961, all of which menace the U.K. economy—specifically its capacity to export, and its ability to safeguard its currency—more than that of any other industrial country. He cites the thumping U.K. deficit in the balance of payments of 1960, still not overcome by a big enough reduction in the rate of imports (at even today's relatively low prices) or a big enough boost in our exports. He cites our continuing inability, therefore, to undertake net new exports (investment) of capital overseas on our own account for development purposes, *without at least an off-*


NATIONAL INCOME
Increases 1950 – 1960
Percentage Increase
£m
1,000
2,000
3,000
4,000
Personal Consumption
28%
Fixed capital formation
63%
Exports of goods & services
37%
Public authorities' expenditure on goods & services
22%
Percentage Increase since 1950
Personal Consumption
Durable Goods
166
1960 228
Alcoholic Drink
Food
Tobacco
Housing
Clothing
100
110
120
130
1950
1955
1960
Fixed Capital Formation
dwellings
plant & machinery
manufacturing industry
100
120
140
160
1950
1955
1960
SOURCE: National Income Publications
NOTE all the above charts are in terms of, or are based on, 1954 prices

setting import of long-term foreign capital into U.K. businesses, properties, etc. He cites our consequent growing dependence on others' exports of new capital—both to the less-industrialized lands and to Europe (including Britain)—but emphasizes the intensified, intensifying (German and American) tendency to "tie" more of the spending of such loans to goods and services of the lending countries. He nastily observes that this cuts away one of the British optimist's props in the latter's cosier argument about the negligibility of our terms of trade. He further points out that we did poorly, registering the only unbroken fall in a share of the expanding world market for manufactures, compared with the shares of other industrial countries, between 1951 and 1961, when we were exporting capital heavily all the time, and other lenders were not "tying" their loans.

What, therefore, he asks, do we expect to occur to our economy when we can't export capital as we did, and they "tie" more and more of their extra exports of capital to their own exports of goods and services? Is it not at least as likely as the optimist's estimate (asks this pestilential fellow) that the new American, German, and other development programmes at home and abroad will (*a*) raise the levels of investment and consumption in under-developed lands, by loans that the U.K. cannot match or in which it cannot even participate; (*b*) consequently raise the level of world prices of materials and foods, as more of them get consumed in places of origin, or in the more dynamic domestic economies of the industrial, lending countries (Germany, the U.S.A., etc.); (*c*) "tie" the spending of the new investment more to the exports of services and manufactures from the lending countries; and (*d*) thus menace the U.K. economy (though not necessarily sterling, since the overseas sterling countries would be both earning and borrowing more from foreigners) by an unprecedented, two-pronged, simultaneous drive against both its terms of trade and its ability adequately to profit from a world-wide pick-up in the exports of goods and services?

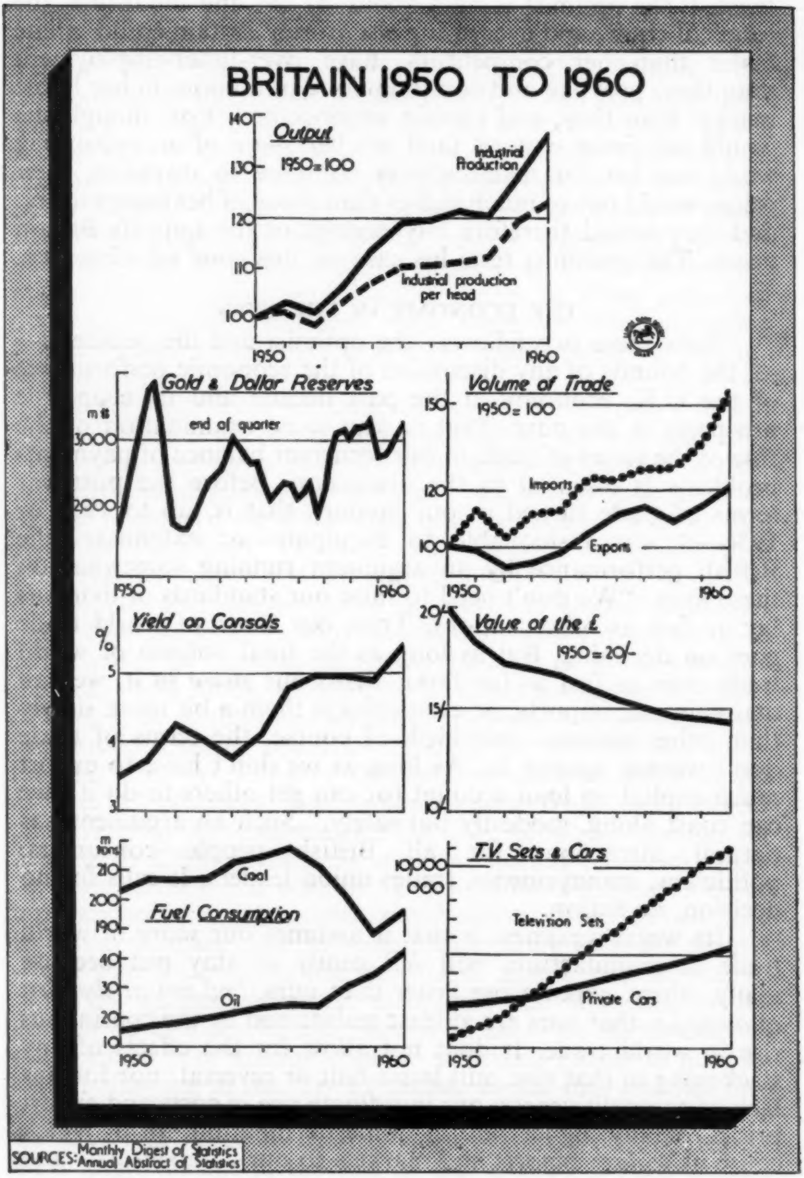
This galling pessimist also, like the optimist, works himself up to a peroration. Surely, he asks—as rhetorically as the optimist over unemployment—if Britain put up as poor an export showing in the '51–'61 decade as she did, and ran into such periodic crises in her balances of payments as the one we have still failed to resolve, must we not prudently expect little improvement in the rest of the 'sixties? If help cometh it hardly looks—yet—to be forthcoming from ourselves alone.

From whom else, then? This thorn in our flesh gives a final twist. If the optimist is right about '51–'61 and the future, the terms of trade, and everything else, surely Britain could inflate faster than her competitors, have over-fuller-employment than they, provoke and continue more of a boom in her home market than they, and remain unconcerned. For, though she would sell fewer exports (and see her *share* of an expanding world market for manufactures continue to dwindle), their prices would rise so much higher than those of her competitors; and they would therefore buy enough of the imports Britain needs. The pessimist rests his case on this *quod est absurdum*.

THE ECONOMY IN THE 1950's

Now these two fellows—the optimist and the pessimist—set the bounds of any discussion of the economic performance of the U.K. economy in the past decade and its economic prospects in the next. That is why some examination of the rôle of the terms of trade in our recurrent balance of payments problems is essential to the discussion. Before the post-war terms of trade turned in our favour—that is, up to 1955 or 1956—it was fashionable to exculpate—or extenuate—the British performance by an argument running somewhat on these lines: "We don't need to raise our standards of living as far or fast as other nations. True, our *share* of world trade goes on declining. But as long as the total volume of world trade rises as fast as (or faster than) our *share* in it, we can maintain our imports, or even enlarge them a bit more slowly than other nations—provided, of course, the terms of trade don't worsen against us. As long as we don't have to export much capital on loan account (or can get others to do it), we can coast along, modestly but safely." Such an argument has natural attractions for all British people—consumers, politicians, managements, trades union leaders. It calls for no decision, no action.

Its worst weakness is that it assumes our *share* of world trade in manufactures will fall gently or stay put because many others' exports rise faster than ours, *and not at the cost of ours;* i.e. that ours are at least maintained by the continuous rise in world trade. It does not allow for the effects of any slackening in that rise, still less a halt or reversal; nor for our lack of competitiveness, our inordinate rise in costs and export prices, or any higher rate of domestic inflation, all of which cause us to *lose* exports and markets to our competitors—and not merely to miss getting into entirely new markets, or


BRITAIN 1950 TO 1960
Output
1950=100
Industrial Production
Industrial production per head
140
130
120
110
100
1950
1960
Gold & Dollar Reserves
m $
end of quarter
3000
2000
1950
1960
Volume of Trade
1950=100
150
120
100
Imports
Exports
1950
1960
Yield on Consols
%
5
4
3
Value of the £
1950=20/-
20/-
15/-
10/-
m tons
Coal
Fuel Consumption
Oil
210
200
190
40
30
20
10
1950
1960
T.V. Sets & Cars
10,000
Television Sets
Private Cars
1950
1960
SOURCES: Monthly Digest of Statistics
Annual Abstract of Statistics

getting more of old ones. And it makes no provision for a worsening in our terms of trade.

The disturbing features of our entire economic performance in the last decade—not of our exports alone—are these: (*a*) our costs and export prices rise faster and farther than those of our competitors; (*b*) our productivity rises more slowly than theirs; (*c*) our rate of investment in new capital equipment for private enterprise (on which *all* our exports depend) is the lowest among the chief industrial countries and still lags below theirs; (*d*) the rise in our imports, largely due to domestic inflation, has been one of the biggest and, *apart from* our short-term borrowing, it has been defrayed almost completely by the turn in the terms of trade in our favour; (*e*) we have lost markets within the sterling area (despite "imperial" preference) and only less so among other countries exporting primary products, and have gained exports only in the advanced and developing markets of North America and Western Europe, which demand more versatility and adaptability from our exporters ; so that (*f*) it has become progressively harder for us to keep up our exports to primary-producing countries unless they are linked to our own and other Western countries' "untied" loans of new capital to such countries.

The upshot of this is that our export trade has undergone a great change. It is more dependent than ever before on (i) "untied" loans and other finance for development of less-industrialized nations, (ii) competitiveness in non-sterling and highly-developed Western markets (U.S.A., Canada, Western Europe, etc.), and consequently (iii) the manufacture of newer lines, new applications of technical progress, etc.

In some lines our exports have put up remarkably good performances: e.g. cars, commercial vehicles, aircraft, office machines and equipment, new chemicals, electronic and other precision instruments or apparatus, heavy civil engineering and contracting work, heavy and light electrical equipment, etc. In others—mainly the older, established lines of British exports, like coal, shipbuilding, many consumers' goods (especially the older textiles), leatherware, clothing and footwear—our exports are way below those of pre-war years in volume, sometimes even in value; and they either stay stable nowadays, or diminish steadily. But even our "good", new export lines are now menaced by the quicker rise in our costs and prices, not offset by a faster rise in productivity. And by protection, subsidies, grants of public funds, etc., we keep up,

or even expand, productive capacity in lines where curtailment should occur.

* * *

An outside economic observer would expect that during the past decade (and particularly during the last five or six years) there would have been considerable switching of Britain's natural resources—of which labour is the most important—from "declining" lines to "advancing" ones; from the static to the dynamic trades; above all, from the home trade to exports, from consumption into more over-all saving and investment, and possibly from imports of consumer goods to investment in imports of more producers' goods. Only so (he would reason) can Britain hope to stop the long decline in her share of the world market for manufactures, carve out for herself an unassailable part of the newer and more rapidly developing markets for such goods (America, Western Europe) in countries that *don't* demand new loans from her, and thus face with equanimity the inevitable turning of the terms of trade against her once more, when the American recession is over and the world prices of primary products rise in response to resumed demand.

The outside observer would further expect a country so economically vulnerable to take special steps to stimulate enterprise and initiative, to encourage savings and investment, to boost rewards for management and responsibility and skill at all levels, to furnish fiscal advantages for firms that instal labour-saving machinery or otherwise modernize, and (above all) to arrange its employment, tax, housing, farming, welfare and other governmental policies in such a way that economic rigidities and frictions would be reduced to a minimum, and transfers of resources adaptability, and flexibility would be at a maximum. He would not expect to see an over-boiling home market highly protected by tariffs, insulated from foreign competition and made safe for inflation and the passing-on of rising costs to home consumers in an endless process.

The economic observer will therefore have been somewhat disappointed in Britain's performance from 1951 to 1961; particularly since 1957. He will be puzzled about her economic prospects from now on, in the light of so many recent and impending economic changes in the outside world. He will have noted the vast expense of tax funds upon keeping labour and older industries in the same places—and upon encouraging already-existing industries to expand (even over-expand) from places where unemployment was already threatened or actual,

into places where it was even heavier (*cf.* cars, steel, passenger-ship building). He will have seen the Welfare State administered in such a way that no full-time unemployment was allowed, and no part-time unemployment was permitted to result in transfers of labour; that weekly pay-packets for the short-time employed (and therefore short-time unemployed) were made up to well-nigh fullness from social security funds; that employers could easily run down their payrolls without discharging workers, because the full-time employed population paid high compulsory contributions to keep those short-time employees for half the week. He will note that our personal tax system—unlike others, even those that tax personal incomes as heavily—begins to bite into earnings at exactly the levels of income where responsibility and supervision begin; and that managerial earnings or those of the most skilled and trained persons are penalized in all imaginable ways.

He will have noted the leading part in all this played by our domestic inflation. Being fair and objective, he will note that our inflation was more rapid up to 1955 than in our chief competitors' countries. As measured by prices of consumers' things, however, the value of money in Germany and the U.S.A. fell by 10 per cent. between 1955 and 1960, and only by 12 per cent. in the U.K. But there he will let the optimist and the pessimist take up their argument again.

PRICES HERE AND ABROAD

The optimist says: Our inflation isn't as responsible for our peculiar economic ills—our recurrent crises in the exchanges and the balances of trade and payments, which cause every government spasmodically to dash from sedating the economy to pepping it up with "purple hearts"—as the pessimist makes out. If you take export prices of manufactures *in U.S. dollar terms* (i.e. in the main world currency which has not been devalued since 1938) you find that from 1949 to 1961 prices of U.S. manufactures have risen by 25 per cent., while the prices of our exports are about unchanged on balance. In other words, we have just about exhausted the benefits of the devaluation of 1949; but German export prices (also measured in dollars) have fallen by about 15 per cent. over that period. This partly explains why we and the U.S.A. have both run into exporting (and balance of payments) problems in the last couple of years; and why the Germans haven't. (The up-valuation of the German currency this year

appears all too little in this setting of *dollar* values of exports of manufactures.) Indeed, if you take 1938 as a base-year, we have lost little of our competitiveness in exports compared with Germany; and we have greatly improved it in comparison with the U.S.A. True, for historical and other reasons, we have a peculiarly vulnerable economy, which swings farther from extreme to extreme than those of other industrial nations, and in shorter, recurrent cycles. But (says the optimist) our performance in the 'fifties was remarkably good; our present situation and prospects are not disturbing. Big changes are afoot abroad; we shall get our share of the improvements they spell; and, after our import boom, due to re-stocking and liberalization of our import trades, we shall resume the rate of growth in the economy, and in our people's consumption, which has been so satisfactory in the past five or ten years.

To all this the pessimist has his responses pat. He at once declines to accept the optimist's statistical measures of inflation, or of the values of exports. He points out the following as modifying—even in some cases vitiating—factors. Sterling was devalued at the outbreak of the second world war from about U.S. \$4·60 to \$4·03, before its *second* devaluation, by the Labour government, to \$2·80 in 1949; the German mark started its post-war life in 1948; the U.S. dollar has not been devalued at all since 1938. So if the U.K. economy, on the optimist's own showing, has already run through all the competitive advantage gained on Germany and the U.S.A. in 1949, it must face from now on a fundamentally less favourable alteration in its circumstances.

Secondly, the pessimist points to a significant and singular feature of the figures: the U.K. is the *only* one of the leading industrial economies to show over the past decade, at least four things together: (*a*) a decline in its share of the world's trade in manufactures; (*b*) the biggest rise in *export prices* (i.e. quite another measure than its retail price index for its home consumers); (*c*) the lowest rate of investment in private enterprise, which makes all its exports, and (*d*) the slowest rise in productivity. Our persistently annoying pessimist therefore refuses to be impressed by the optimist's statistics. In, of, and by themselves, he says, he neither denies nor decries them; he only insists on treating them as the separate, static, probably unrelated, series which (he declares) is all they are.

Look at the dynamics—or, rather, lack of dynamics—in our *over-all* economic performance, he asks of us. How comes it, he asks, that we have only once since 1949 contrived to get

comparative stability in our retail prices (during three out of the last four years) and then only at the cost of comparative stagnation in growth of our national income and our exports alike? How is it, if we haven't been doing *something* worse than our chief competitors, that we have steadily lost exports to them; have had to force our economy to stagnate compared with theirs for three to four years; and have *pour comble de bonheur* had to undergo another protracted crisis in our balance of payments for the last two of those years, aggravated by a recalcitrant boom in all domestic activity, and both of them still largely unresolved?

The optimist expostulates that Britain has done at least as well as the U.S.A. in exports and balance of payments for these last two or three years; and hasn't had 6 or 7 per cent. of its available labour force unemployed. The pessimist winds up by drily observing that the U.S. balance of trade, *without aid*, has been positive all along; that U.S. *aid* has hitherto been largely "untied" (and has therefore largely benefited British exports) but now isn't, and will be less so; and that, although U.S. prices have recently risen almost as fast as those of the U.K., the dollar has not once been devalued since 1938. Consequently, the pessimist concludes, the U.S. economic performance has been pretty staggering as a competitive achievement; so what will its effect on the U.K. and its export trade be if *anything* is arranged (internationally equivalent to devaluation of the dollar) to make dollars more liquid and easier come by?

* * *

The objective observer can hardly be enlightened by the lively exchanges between these extremists. He seeks light on such puzzling features of our economy as the steady resumption of inflation whenever one of our periodic crises in the balance of payments or of trade is overcome. He notes with satisfaction the long run of comparatively stable prices since 1957; but with less satisfaction the resumption of the rise in costs and prices since last autumn. He also notes the inability of British governments—unlike most of those in our competitors' countries—to restrain public spending; also the growth of the *total* public sector of the U.K. economy (central *plus* local government, State boards and agencies, the undertakings of the Welfare State in all social services, pensions, etc.) at the cost of the remainder. He notes that the public sector's costs rise faster than those of the remainder; that the

remainder pays all these costs; that the remainder makes all Britain's exports; and that therefore the differentially faster rise in "public" costs largely offsets the technical progress, or rising productivity, secured by managements in the remainder (private enterprise).

The outside observer then notes, with misgiving, how persistently small is the proportion of total saving in Britain left for new investment—to raise productivity and offset rising costs—in industry and private business in general. He notes, further, the lag in economic growth of the U.K.—especially since 1956–57—accompanied by such startling unexpectations as, very often, lagging productivity in the industries or firms which *have* carried out heavy new investment programmes since Mr. R. A. Butler's "invest in success" budget of March, 1954. He wonders if there can be some common "lag factor", some built-in element in the U.K. economy, inhibiting dynamism, growth, and the full realization of normal economic expectations from new investment in productive apparatus (whether in public or in private enterprise). He thinks of the rate of growth of the over-all public sector, the Welfare State and its costs, and the persistent high levels of British taxation.

A REMARKABLE BUDGET

Amid all the evidence of great economic changes in the world, the British people have just had a remarkable budget. It broke entirely new ground in many ways. It could mark a watershed in British fiscal practice, in monetary and broad economic control over the U.K. economy, and in social policy, alike and at once. (It also couldn't; which is why it is symptomatic, and why closer analysis of it is needed to determine what—if any—new principles are implied for the future, and what new practices may ensue from it.) Why, first, was the budget of 1961 remarkable? Secondly, what does it portend? Can the objective observer get clues to the puzzling British economic prospect from the budget and the Commons debates on the Finance Bill?

The only real concession made in this year's budget, a long-overdue one, was to surtax-payers. But it was at the cost of substantial net new imposts upon private enterprise, and even upon export trades. The so-called proposal for a variable payroll tax, for variable periods, uncoupled from any fiscal stimulus to invest in new labour-saving equipment, is simply a flat-rate poll-tax on *all* enterprises and *all* employment—public as well as private. So no industries or exports are

specifically encouraged and no one is advantaged but the Revenue. Much the same criticism can be made of the three other imposts on British industry: the lift in profits tax from 12½ to 15 per cent.; the extra 2d. on fuel and other heavy oils which hits modernized firms most, and businesses, e.g. making glass, steel, etc., or in horticulture, dependent on oil; and the so-called television-advertising tax.

To tax profits more heavily at the present juncture is to put managements in the position of quickly having to find more working capital, after the Revenue's average cut from their profits of 50–55 per cent., or else reducing dividends. The latter course jeopardizes present and future borrowing, or raising of fresh capital. So the new profits tax (whatever economic or fiscal theory says) will probably lead to quicker rises in prices (especially in the home market), and meanwhile —till fresh capital can be raised, or bigger plough-back secured from bigger profits—some extra indebtedness to the banking system. Little need be said about the extra tax on oils; it is obviously and politically "a sop to the Coal Board" (as it was termed in one Commons debate). It will not *reverse* the modernization drive from coal-firing to oil; so it will provide the extra £50 millions or so of revenue required of it; but it will raise costs, and it will *delay* modernization.

The oddest new tax is that (ostensibly) on advertising by television. It is almost a classic offence against all of Adam Smith's famous canons of taxation. Purporting to hit at the profits of the programme-contracting companies, it was admittedly expected to be passed on to advertisers. Since these people and their advertising agents work to budgets of their own, and TV has the biggest impact on their markets, its effect will be completely to by-pass TV advertising, and come to rest on all other forms of advertising. It would have been far better (as Lord Hinchingbrooke and many others in all three parties in the Commons pointed out) to come out into the open with a straight tax on all advertising.

* * *

The improvised nature of this year's budget perhaps stems from the short time the present Chancellor had been at the Treasury, the long tussles in the Cabinet during his predecessors' tenure of office (Mr. Thorneycroft and Lord Amory), and the inability to get that long-overdue radical

reconstruction of Britain's chaotic, haphazard, fiscal system which leading civil servants, politicians and economists (irrespective of party politics) know to be necessary. Thus, in a sense we are still back in the days when the Conservatives took over from the Socialists a decade ago: waiting for reforms in taxation, company law, etc., which imposing majorities on Royal Commissions and innumerable committees then demanded, but no one has yet dared politically, or found the time or energy, to carry out. To that extent the fiscal framework of the British economy remains remarkably similar to what it was under Labour—or under Mr. R. A. Butler or Mr. Macmillan when they were Chancellors of the Exchequer—although the framework of world trading and finance has meanwhile been fundamentally altered.

Mr. Selwyn Lloyd has produced a budget which has certainly broken post-war precedents by giving the first real incentives to the upper levels of British management; and by taking powers to vary *between* annual budgets a withholding tax on *all* payrolls, and a lot of indirect taxes. These latter innovations give the authorities better instruments to exert, quickly, fiscal rather than monetary control over the economy. That is certainly badly needed in Britain's over-boiling home-market, boosted all the time by protective and over-full employment policies and practices. But this year's innovations are far from ideal or effective, because they are too generalized. They do not hit directly enough at the home-market trades. Mr. Lloyd's budget bears the marks of a hastily-prepared, temporizing "holding operation". He has said that in the breathing-space it secures, better fiscal instruments will be devised. (The Prime Minister even went so far as to say the new "payroll tax" might never be needed in the few months of life which, at most, is all it can have.) So this budget must be deemed clueless, and everybody must just "wait and see".

By this time, therefore, our outside observer—who of course wishes Britons well—will be hoping that in the fiscal year 1961–62 the Macmillan Administration and the civil service will at long last radically overhaul the fiscal and administrative structure on which the U.K. economy rests. He will be trusting that they do so before the economic advance of the Six in Europe, of the revitalized United States, and of the Russian system intensifies competition for British exporters, ties new loans to their grantors' own exports or shipping, and makes other inroads into the markets for British goods and services.

PROSPECTS FOR THE 1960's

There is now a fair chance that the volume of world trade in manufactures *will* expand at an accelerating pace, so that —even if the British economy lags, and its costs go on rising faster than those of other industrialized countries—Britain will be able to maintain her hold on existing markets: to maintain it, i.e. to stabilize her exports, but not to expand them enough. That seems to have been her accomplishment in the last 18 months of "export drive". It holds out to the British people for the remainder of the '60's the prospect of doing about as well as now, when they "never had it so good" (as their Prime Minister had told them)—provided they do no better with their exports, but all other countries do.

Owing to our peculiar combination of political apathy with other characteristics, in politics and management and unions alike, that may be precisely what the nation will settle for, or acquiesce in. After all, they could have done differently in the '50's had enough of them wanted to, and had they dared to raise a lot more hell with the various protected or subsidized groupings and vested interests, including of course first and foremost the trade unions.

Secondly, we can go on consuming more and investing less than others. It is wrong to think that massive new net investment in productive equipment *necessarily* spells economic growth.[1] British nationalized industries, and even private enterprise, have invested a lot in it since Mr. R. A. Butler's "invest in success" budget of March, 1954, with its overtones of "doubling the standard of life in 25 years". The rate of growth in our national product over the past seven years certainly implies doubling our standards in 26 or 27 years. But the good rate of growth was up to 1957. Since then we have had two distinct crises in our balance of payments; high interest rates; continuing rises in labour costs; not much rise at all in national income; productivity lagging behind that of others; and costs and prices out-pacing theirs. Yet our people *have* continuously had higher earnings and standards of consumption, more leisure and more amusements for less work, than others (except Americans). Even between the beginning of 1960 and of 1961 earnings went up 6 per cent. but the national output hardly budged. National character bites deep. William of Malmesbury, born of Anglo-Saxon and Norman parentage and writing about the disaster of 1066,

[1] See Colin Clark's *Growthmanship*, Hobart Paper No. 10, Institute of Economic Affairs, 1961, 5s.

declared it to be "an innate quality of this people, to be more inclined to revelling than to the accumulation of wealth".

Thirdly, our prospects in the '60's may be fairer than our performance warrants, because great changes are going to be made by other nations in trade and financing. These changes will affect us as much as anybody—whatever we do or don't do. One thinks of the spreading pattern of international investment, by private enterprise—American, Canadian, British, German, French, Dutch, Swiss—and of the high degree of interlocking ownership being reached. One thinks of the syndicates and consortia, sometimes in direct (more often indirect) partnership with the Russians, Poles or other Communist States. One thinks of the change now under way in the organizing of inter-governmental lending at long term, or of co-operation between central banks for the safeguarding of currency values and relationships. There will be a favourable overspill from all this on the British economy.

Fourthly, in all countries the build-up of capital necessary to double the output of machine-tools or productive machinery of all kinds is slow. So for at least the '60's the capacity of the British economy to make exports of producers' goods may be pretty fully engaged. The rise in standards of life for the poor mass of humanity, and the accelerating application of new technical discoveries and techniques, reinforce this influence and render savings and new capital more necessary in the world. Britain can supply part of it. She can even supply a dwindling share, at the cost of slowing down, or halting, the rise in her own people's standards. But then what her people get as a standard will depend, not on what *they* or their governments do, but on what others do abroad to push up world trade and standards of life.

When you have said these things, you have said all you can legitimately say to justify the British in putting up another such performance as they put up in the past decade. But you must point to the hazards the economy will run if it cosily reposes, in familiar attitudes, on familiar arguments, and goes on as it has been going on since 1956–57. The outstanding hazard—already mentioned—is that of the terms on which British exports may have to exchange for Britain's vital imports. To offset it, we must be able to export more.

Another hazard is competition. Accommodation will certainly soon be reached between the Six and the Seven—whether Britain "goes into the Six" or not. Americans and Continental Europeans will have it so. But then our agri-

culture and horticulture, our industries, even perhaps our nationalized and other "service" industries, will be affected by keener and more varied competition. The U.K. tariff has hitherto been among the higher tariffs of Europe. It will have to come down on many things. (How can we logically deem our high tariff necessary on motor-cars or precision instruments, industries which export heavily?) Even if this is a slow process—if subsidies, grants and other cushions continue to be erected round certain British vested interests (those of unions as well as of managements) at our taxpayers' and exporters' expense—the growth of the Six is likely to be faster than that of Britain (as it already has been) because of the widening market and keener competition. So Britain may have to fight harder in commercial terms in the '60's for the raw materials she needs. (She will probably get the food she requires without much difficulty.) Savings and capital can hardly stand at a premium throughout the world, and business activity run at peak levels, without imparting an upward thrust to the world prices of the things we need to import. Indeed, if we go on being less and less competitive, we shall go on importing producers' goods as well, and exporting less.

The American and German attitudes in all these matters are unmistakable. Their policy is to boost the economies of the less-industrialized countries by way of new loans, and to boost the exports of producers' goods and technical know-how from America and the Six, *irrespective of the terms of trade* (since the terms of trade are virtually unimportant to them). But they are vital to the U.K. In other words, of all the industrial exporting nations, Britain can least afford to ignore the terms of trade, and therefore the rate at which her costs and prices move up in comparison with those of her competitors. She ignored it in the '50's, and put up the poorest performance. In view of the changes going on, she can scarcely hope to go on ignoring it with impunity. She can certainly not content herself with waiting for the leading nations' central banks to issue more "cloak-room tickets" to each other, in the hope that she can go on claiming more cloaks than she makes and puts in the common cloak-room.

* * *

Which brings us back to the two basic elements in our post-war economic problems: controls over our domestic inflation, and the lagging rise in our productivity. They are of course related. If we could push up productivity at a rate

exceeding the inflation (caused by government financing, the nationalized industries, and other vested interests) we should do better than the U.S.A., not worse (as we did in the '50's).

As it is, we pre-empt our national savings, first, for shoring-up governmental services and nationalized industries of all kinds; secondly, for subsidizing *generalized* current consumption (pensions, the National Health Service, housing and other subsidies, etc.), and not the consumption only of those in need; and, thirdly, for spasmodic stabs at long-overdue improvements in the nation's network of communications. Only after all that do we leave what's over to private enterprise. Then when it has been invested, either the trade unions officially, or their members misled by unofficial agitators, insist on working new equipment so that it cannot turn out any more in the same time than the old it replaced, and then with the same numbers of workers employed. Owing to the over-full employment policies and the "dash of inflation" every now and then, managements in the same industry refuse to stand shoulder to shoulder to uphold the authority of the unions' *official* leaders. On the contrary, these managements, with over-full employment, run their affairs as if it were a *sauve qui peut* for labour, stealing from each other, giving in to every new demand by unofficial leaders, and in every way boosting the upward inflationary spiral of labour costs. If those rising costs were, if they ever were permitted to be, offset by investments in new capital and by new methods, our problems would be solved.

All of Britain's post-war crises, unbalances of payments, etc., would never have occurred if productivity had been rising by one-half of 1 per cent. per annum faster, or if total output had kept running 2½ per cent. higher. As it is, and as it was throughout the '50's, the over-full employment, the inflation, the protective and subsidizing policies, and the rigidities and restrictions on productive efficiency in the British economy have combined to stultify even the programmes of new productive investment. That is the moral of the past decade wherewith to face the next.

FAR-REACHING ECONOMIC REFORMS NEEDED

For all these reasons, the budget and the economic policies of H.M. Government, as so far clarified, will not serve to give the economy the long-overdue overhauling it badly needs. What is needed is a national shake-up: not along the old, political-party lines but along entirely new social, mainly

economic, lines. The British people, lulled by their leisure and their wide pursuits in it, cannot be blamed if they "couldn't care less" for the country's economy. But in the light of the changes going on among the leading nations of the world, Her Majesty's Government will be increasingly blamed if they do not come out with a programme of economic reform, inspiring and forward-looking, going to the roots of our problems. It must dissipate the drowsiness injected into our economic life by four sedatives: the Welfare State, the Hampering Fisc, the Cushioned Interest, and the Long Inflation. The vicious upward spiral in our costs and prices is only the obverse of the vicious, downward screw on initiative, skill, and dynamism exerted by those four sedatives. For the Prime Minister and other Cabinet Ministers to beg industrialists to export more (on the ground that *inter alia* it's "fun"!) to cure a situation inevitably produced by officially-induced security-mindedness, home-market-consciousness, tax awareness, and lack of cost-consciousness, is testimony neither to their powers of diagnosis nor to those of prescription. More—much more than repeated references to the parlous state of the unemployed in Stockton-on-Tees 30 years ago—is needed.

This is not the place to set out a programme; rather to argue its need. Many writers have recently been diagnosing and prescribing for our ills—in this and other bank reviews, in *The Economist*, in the Conservative Bow Group's pamphlets, in those of P.E.P., in the various books and other publications of the Institute of Economic Affairs, among others.[1] Most significant is the widening agreement on our need to halt the inflation in the home market; to increase competition by foreign supplies in our home market; to cut out the restrictive and other uneconomic practices of trade unionists as well as those of employers; to couple incentives for new investment with a real payroll tax that produces a lot more of the Revenue; then to lower personal and profits taxes, and make a more "affluent society" pay more for its Health and other Welfare services (giving them free only in cases of need) and reduce its farming, food and other subsidies; and to lean heavily on the new fiscal, rather than the old monetary, measures to secure and maintain an over-all balance in the economy. A welcome beginning on the last item has been made by this year's budget, by making taxpayers find enough to cover *all* the government's needs. Yet industry and enterprise have had to pay the bulk of

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[1] The author's version appeared in *The Times Review of Industry* last January.

the new taxes—which is anti-dynamic fiscal practice—instead of the booming home market. The real need is to stop trimming, plastering and patching; to make a real overhaul, a radical reform, in the fiscal framework of the national economy; and to do it by ensuring that resources *will* be switched from the home trade to exports, because the home market is less protected, less subsidized, less profitable.

Signs that it is urgently necessary are there to be read. Among a rapidly growing minority of responsible people there is a sense of malaise, of political apathy and disarray; a feeling of belonging to the only nation without aim or inspiration; of being borne down by imposts, restrictions and hindrances on any kind of effort to achieve quality, innovations or improvements. On the other side of the water, our friends and neighbours not only aim at, but attain, achievements of which we thought them incapable five or ten years ago. They have undergone the divine *afflatus* from the "winds of change". Their economies, their peoples, show the results. It would be no bad aim for our political parties, our managements, and our trade unions to work out forthwith how to reverse the British showing, as against theirs, in the past decade.

It is idle to say this kind of radical, but progressive, economic and social reform will not make some people, some firms, and even some whole industries, squeal. When the willing horse, the hardworking breadwinner, finally drops dead, those that live longer than he on "the soft touch" are the loudest not to praise, but to blame him. It would lighten the load on Britain's businesses and other taxpayers if the Welfare State benefits, the farming and industrial grants and subsidies, and the (now fairly high) protective tariffs were no longer *generalized*, but were all revised to apply only in *specific* cases of need or strategic requirement. It would therefore be cheaper, and help to lower costs, if much less public money drawn from taxes, rates and levies were prodigalized, as now, in the broad channels; and if much more than is now spent were devoted through narrow and specified channels to compensation, re-training of redundant workers, their re-settlement, and the fiscal encouragements to establish entirely new trades in places where old trades are passing away. It is worth pointing out that even now—despite the depression in the cotton industry, foreign and Commonwealth competition in it, and the public fund of some £32 millions set up to compensate firms "consolidated" in it—there is an over-all shortage of labour, skilled and unskilled, in the North-West region, due to demand for it

from newer trades. The problems arising from the transfer of resources to exports from the home trade, and otherwise—which the authorities could secure by new fiscal measures to maintain over-all balance in our entire economy from, say, quarter to quarter (instead of every two or three years)—are not likely to be as grave or widespread as politicians fear. The way *not* to proceed is to grant tax money to a company to build a North Atlantic passenger liner in competition with other countries' subsidized vessels, when the company itself is applying for permission to spend millions on American jet 'planes to secure part of the growing air traffic over the Atlantic, and in competition with a British, State-owned, airline. It is *not* to make British coal unnaturally dear by new duties on oil, and then forbid cheaper foreign coal to British industrial exporters. That, in Bentham's phrase, is not plain nonsense; it is nonsense upon stilts.

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One conclusion can safely be stated. If we go on making the showing that we have made since 1956–57, we shall be in a much more serious plight than we are now, long before 1971. The world is changing fast. So are our friends and neighbours. We must change fast, too. And we must not be afraid to do so; for in so rapidly changing a world, if we do not change by our own set purpose, we shall suffer change by trying *not* to. It is better not to wait for that to happen to us. Meanwhile we need a lot of hard thinking and plain speaking, if we are to start and finish a long-overdue job in time.

London,

June, 1961. Graham Hutton

Money, Liquidity and Interest Rates

By E. Victor Morgan

MONEY AND PAYMENTS

THE past few months have seen some notable contributions to the discussion of monetary matters initiated by the Radcliffe Report, and it is now possible to pin-point much more exactly the differences of opinion that still exist. This article is concerned mainly with interest rates, and particularly with the relationship between long-term and short-term rates. First, however, it is necessary to discuss briefly some fundamental monetary concepts that have been the subject of controversy.

It is generally agreed that we need to distinguish clearly between the abstract unit of account or "standard of value", the instruments that are used as means of payment, and the assets that provide a highly liquid store of wealth. The text-books have long pointed out that "money" performed all these functions, but the use of this single word has tended to obscure the fact that some instruments possess some but not all the qualities of "money". The unit of account may be identified with a particular means of payment (as it was under the gold standard) but this is by no means necessary. The pound sterling has, in fact, survived since Saxon times as a unit of account, though the means of payment have been silver, gold, inconvertible notes or simply entries in the books of a bank.

The means of payment may change drastically over long periods of time but at present coin, notes and bank deposits are the only things generally accepted in final settlement of debts. Postal orders occasionally pass from hand to hand (notably through the football pools) and there are still some pure barter deals (the schoolboys' swapping of stamps), but these transactions are negligible and there is no evidence that they are growing. Indeed, it may be argued that the range of accepted means of payment has narrowed considerably during

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the past century and a half. In the early nineteenth century tradesmen's tokens often circulated along with coin, some industrial firms as well as banks issued notes, and bills of exchange frequently passed from hand to hand, but all these practices have ceased.

There is no doubt that coin, notes and bank deposits serve as means of payment in a way which nothing else does, and this has been the reason for regarding them as money and for denying that title to other financial assets. Whether or not that distinction is economically useful depends upon the answer to two further questions: If the supply of money is restricted will new means of payment speedily arise and, if not, can the volume of spending still increase by the extension of credit, thus delaying the final settlement of debts for which money is needed? On the first point, all the historical evidence suggests that it takes a very long time indeed for a new means of payment to arise and become generally accepted. The only exceptions to this have been paper currencies issued by governments to replace metallic coin in an emergency, as were the Treasury notes of the first world war.

The problem of credit is a much more difficult one. Mr. H. B. Rose has recently made the important point that credit can finance only "intermediate transactions", i.e. transactions between firms, and not "net value added", i.e. a growth in the national income as normally calculated. This is because the value of any addition to the national income consists of the wages, salaries, rent, interest and dividends earned by the suppliers of the factors of production, and these people do not normally give credit but have to be paid in money. Changes in the ownership of existing goods can be financed by credit but, once a firm begins to work up raw materials, to process semi-manufactured products, or even to transport goods from one place to another, it has to make payments to factors of production that can only be done in money. It is, of course, changes in national income that are of primary importance from the point of view of monetary policy, and an increase in national income must ultimately imply an increased use of money. The extension of credit can, however, delay the rise in the volume of money payments by temporarily slowing down the volume of payments *between* firms as the volume of payments by firms to factors of production increases. This, however, can be no more than a delaying action; all debts have finally to be settled and money remains the only generally accepted means of settlement.

If this reasoning is correct, it is still useful to distinguish both between money and other liquid assets and between the banks and other financial institutions. It is, however, the volume of bank deposits rather than any particular type of bank lending upon which monetary policy should operate. Sir Oliver Franks has emphasized the difficulty of cutting advances (or even checking their rise) quickly and, even if this difficult and unpopular exercise is carried through, the effect is likely to be limited and very temporary unless it is also accompanied by a similar check to deposits.

THE VELOCITY OF CIRCULATION

Though it is generally agreed that a very drastic change in the quantity of money must affect the price level, there is still wide difference of opinion as to the precise way in which the two are connected, and the closeness of the link. A change in the price level will obviously affect the total value of payments being made in money, and so different views as to the closeness of the connection between the money stock and the price level imply differing opinions as to the importance of changes in the velocity of circulation. These differences range all the way from Mr. Manning Dacey's, "Provided the quantity of money is kept on a tight rein, it is unlikely that an inflationary rise in velocity will get out of hand",[1] to the Radcliffe Committee's, "we cannot find any reason for supposing, or any experience in monetary history indicating, that there is any limit to the velocity of circulation".[2]

Here there is need for far more research, but such evidence as we have is much more in favour of Mr. Dacey than of the Committee. The periods of hyper-inflation, when velocity has risen very greatly, have always been associated with great increases in the volume of money, usually because governments have resorted to the creation of new money to finance a budget deficit. At other times there have been quite numerous cases where a reduction in the volume of money (or a check to its rise) has not been frustrated by changes in velocity, but has been followed by reduced spending and falling prices. Moreover, the very thorough study of deposit velocity in America by Dr. George Garvy[3] strongly suggests that the

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[1] W. Manning Dacey, *Money Under Review*, Hutchinson, 1960, p. 16.
[2] Radcliffe Report, para. 391.
[3] George Garvy, *Deposit Velocity and its Significance*, Federal Reserve Bank of New York, 1959.

behaviour patterns of the persons and institutions who hold cash are fairly stable in the short run and that there would, therefore, be strong obstacles to an indefinite increase in velocity.

There will not be any clearly defined ceiling beyond which velocity cannot possibly rise but, so long as there is reasonable confidence in the future value of the unit of account, there will be a range within which each increase encounters steadily mounting pressure. As velocity rises an increasing number of persons and institutions will begin to feel that their cash balances are low in relation to the volume of payments which they have to make; in other words, they will feel uncomfortably illiquid. They may react by trying to rebuild cash balances, either by cutting down expenditure, calling in debts or refusing to grant new credit, but these processes will be subtle and difficult to observe. The clearest indicator of how liquid people feel will be the rate of interest, though even this is difficult to interpret because the yields on different types of asset will be affected to a very different extent.

VELOCITY AND INTEREST RATES

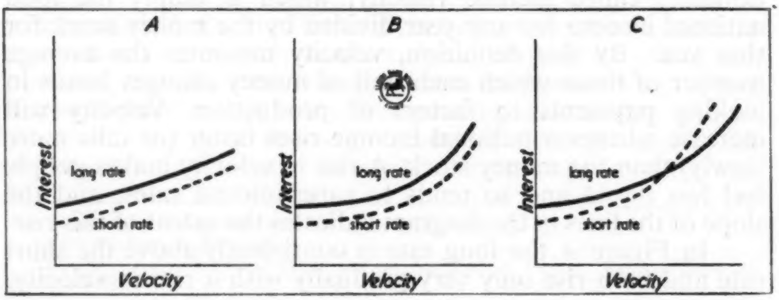
Here, perhaps I may take refuge in two well-known academic devices, a simplified model and a diagram. Consider only two assets other than money, bills and long-term government bonds, the yields on which will be called the long rate and the short rate. The diagram overleaf shows various possible relationships between these rates and the velocity of circulation of money. There are, of course, different ways of measuring velocity, and the choice between them depends partly on the purpose for which the concept is being used and partly on the statistical information available. For our present purpose we can consider the simplest of these measures, normally called income velocity, which is simply the total national income for any year divided by the money stock for that year. By this definition, velocity measures the average number of times which each unit of money changes hands in making payments to factors of production. Velocity will increase whenever national income rises faster (or falls more slowly) than the money stock. A rise in velocity makes people feel less liquid and so tends to raise interest rates, and the slope of the lines in the diagram indicates the extent of this rise.

In Figure *A* the long rate is consistently above the short rate and both rise only very gradually with a rise in velocity.

A very big increase in velocity could occur without producing a rise in interest rates sufficient to be economically significant and, presumably, without any marked increase in other signs of pressure. In a world of which this was a fair picture, operations on the stock of money would clearly be ineffective, as any reasonable change in the money supply could easily be offset by a change in velocity.

Figure *B* shows a very different situation. The long rate again remains above the short rate by a uniform amount; both rates rise very gradually so long as velocity is low but, once velocity reaches a certain critical range, both rates rise with rapidly increasing steepness. In this case, operations on the supply of money would, again, be ineffective so long as the money stock was large in relation to the volume of transactions. If, however, the stock of money was so regulated in relation to the volume of payments that velocity was within the critical range, then quite modest operations on the money supply could produce sharp fluctuations both in short and long rates of interest. The effectiveness of interest rates in themselves as an influence on the level of expenditure is still a matter of controversy. Apart, however, from the direct effects of the rise in rates, there would be the more general effects of the feeling of illiquidity, of which high interest rates are a sign. It is reasonable to suppose therefore that (in these circumstances) operations on the money supply could have an important influence on the total demand for goods and services in the economy.

Finally, Figure *C* again shows a critical range of velocities, but with the two rates behaving very differently from one another. The short rate is much more affected by velocity changes than the long rate, and the two change positions in the critical range. Again, operations on the money supply can



be effective so long as the initial stock is not too large in relation to the volume of payments, but these operations involve the acceptance of a very different rate pattern from that which would emerge in the situation of Figure *B*.

The crucial question is which, if any, of these models is a good approximation to present conditions in the real world. Here it may be worth reverting to the traditional distinction between "active" and "idle" balances. Again this distinction is rather academic, as accounts can rarely, if ever, be firmly ascribed to one category or another. It is probably true, however, that most holders of cash have a fairly clear idea whether their balance (plus their overdraft limit, if any) is small, reasonable, or large in relation to their expected payments. If most balances are "large" in this sense, their owners will obviously not be deterred from any expenditure they would otherwise make by a reluctance to run down their balances. They will also be easily tempted to lend to the few who may want to spend but have inadequate balances; "idle" balances will thus be activated, and a rise in velocity may take place without any marked rise in interest rates. Once the majority of balances approach the lower end of the "reasonable" range, however, the situation is very different. Further economies may still be possible—for example by re-organizing transactions so as to make payments synchronize more closely with receipts, or by arranging for the quicker transfer of balances between different branches or departments of a large organization. Such changes, however, involve alterations in deeply ingrained business practices and habits, and they cannot be expected to take place quickly and on a large scale except in response to a very strong stimulus. So long as money is held primarily as a means of payment, there must be a point beyond which velocity cannot easily increase.

NON-MONETARY LIQUID ASSETS

Further complications arise, however, when we consider money as a liquid asset. Here, coin, notes and bank deposits are not unique, but have many substitutes, some of which (such as deposits with savings banks and building societies) are almost as good as money itself from the point of view of liquidity. Hence it should not be difficult to tempt anyone who holds a money balance that is large in relation to his payments to exchange part of this balance for some other highly liquid asset. The significance of this has recently been

further explored by M. Lamfalussy,[1] who argues that, in certain circumstances, holders of money balances may be induced to convert them into "near-money" assets without feeling any real loss of liquidity, and so with only a trifling rise in interest rates. In terms of velocity, this process would imply the activation of idle balances and an increase in average velocity. In the terminology of the Radcliffe Committee it implies that "general liquidity" can change in a different way from the money stock. The creation of additional "near-money" assets could bring about a rise in liquidity even though the money stock was constant or even falling. In terms of our own diagram this situation would, again, have to be represented by a very flat curve relating velocity to deposits. Whichever way one looks at it, however, operations designed simply to place a curb on the money supply would be in danger of being frustrated by an increase in near-money assets.

In order that this situation may arise, however, a number of conditions must be satisfied. There must be a substantial group of financial institutions whose liabilities are generally regarded by the public as being almost as liquid as bank deposits. These institutions must be prepared to vary their operations substantially in response to changes in the demand for their services, and with only modest changes in interest rates. They must not be inhibited in this either by rules or conventions or by a shortage of whatever liquid assets they themselves keep as reserves. And there must be substantial money balances in excess of what their holders regard as reasonable in relation to the volume of their payments.

Once these conditions are formally stated, it becomes clear that they are only partially fulfilled in our present financial system and that even their partial fulfilment depends more on the government than on private financial intermediaries. Any financial institution which set out to rival the banks, even as a supplier of liquid assets alone, would have to accept loans which were repayable on demand for unlimited amounts and from any customer, either person or company, and would have to offer the same security as the banks against default. There are, of course, many financial institutions that provide some of these advantages for some sections of the community, but none that provide them all for everyone. The government does, however, incur a range of liabilities from which almost everyone can pick assets that, for them, are fairly close substitutes for bank deposits in everything except the actual

[1] *The Banker*, February, 1961.

making of payments—National Savings securities for personal holders, Treasury bills, tax reserve certificates and very short bonds for companies and financial institutions. Thus, the very financial exigencies of the government which provide the major obstacle to an effective control of the money supply also create the biggest danger of an inflationary rise in liquidity. So long as the money supply can be kept to a level that is not grossly in excess of that which the public want as a means of payment, there is little danger of monetary measures being frustrated by an increase in velocity brought about by the activities of private financial intermediaries.

Coming back once more to our diagram we may say that the existence of non-banking financial institutions does not destroy the validity of our critical range in the relationship between velocity and interest rates. They may cause this range to occur with a higher velocity (and so a smaller money stock) than it otherwise would, and they may cause the curve to rise rather less violently than it otherwise might, but that is all.

SHORT AND LONG RATES

It still remains, however, to discuss the behaviour of interest rates within the critical range. Is curve *B* or curve *C* the correct description of the situation that we should expect as the volume of payments rises relatively to the money stock?

There are very strong reasons for believing that curve *C* is the relevant one. It conforms to historical experience; as far back as records of interest rates are available, short-term rates have fluctuated more than long rates, rising substantially higher when rates as a whole have been high and falling much lower when the general pattern of rates has been low. It conforms also to logical deduction from the assumption that borrowers and lenders both behave rationally. Since very short-term securities are the closest substitutes for money it is natural that their prices and yields should be most affected by influences coming from the side of money. If the general level of rates is believed to be high, there will be a tendency for lenders to prefer long-term securities in order to assure themselves of a high return for a long time to come, while borrowers will tend to seek short-term loans in the hope of refunding on less onerous terms in the not too distant future. Hence the ordinary forces of supply and demand will tend to raise short rates relatively to long ones as both go up. Finally, the pattern represented in curve *C* fits in with the mechanism of our present financial institutions. Both the willingness to

spend of individuals and firms and the willingness to lend of financial institutions depends in part on the value of their marketable assets. Rising interest rates, of course, imply falling capital values but a given rise in rates affects the price of long-term securities much more than short ones. Thus, monetary measures can produce their full effect only if they cause short rates to fluctuate more widely than long rates, and monetary authorities should certainly not try to check this natural effect of market forces by intervention.

There are, however, two important qualifications that need to be considered here. First, it may be argued that a model using only one "short" and one "long" rate would be realistic only in a market where the forces of supply and demand were quite untrammelled by convention, so that rates on obligations of similar maturity always moved together. In our present financial system there are, of course, numerous conventions that may affect the behaviour of certain rates. The banks have minimum rates for overdrafts and, above this, their rates (like those which they pay on deposit accounts and those which they charge on a large part of their loans to the discount market) are traditionally linked with Bank Rate. Whatever the forces of supply and demand, these rates normally change only with a change in Bank Rate. Other conventions may even cause some rates to move in a different direction. For example, in a market untrammelled by convention, a sharp fall in the volume of Treasury bills (the volume of short bonds remaining unchanged) would reduce both rates. With the banks' present liquidity conventions, however, the fall in their Treasury bills might force them to sell bonds and, unless other holders switched very readily, the short bond rate might quite conceivably rise. Even so, though some conventions may be of doubtful value, their effect should not be exaggerated. They probably do not greatly distort the pattern of rates for, though some institutions are strictly limited in the types of asset they can hold, others are not, and a great deal of switching can and does take place. In any case, the fact that the movement of certain rates may be inhibited by convention is not an argument against allowing market prices to exercise their natural influence on the general pattern of rates; rather it may be an argument for re-examining the value of any convention that causes particular rates to get "out of line".

The government itself, of course, is in a very different position from that of a private operator in the market. The

government can borrow (and in some circumstances may find itself virtually forced to borrow) in a way which adds to the supply of "near-money" assets. If this borrowing takes the form of Treasury bills, it enables the banks to add to their deposits; even if it takes the form of very short bonds which are not liquid assets in the banking sense, it may still add to the general feeling of liquidity in the economy. Paradoxically, if borrowing takes these forms, the larger its amount, the lower the average rate of interest on the national debt is likely to be. It would be to the purely financial advantage of the government, as Dr. Dalton saw, to keep interest rates low and stable by so arranging government borrowing as to flood the economy with liquid assets, but this involves giving up any form of monetary control. If changes in liquidity are to be used as a regulator of the private sector, the authorities must permit, or even initiate, the kind of changes in the level and pattern of interest rates that would accompany changes in liquidity in a free market.

FUNDING AND THE MONEY SUPPLY

This seems to run directly counter to the argument for low short-term rates so forcefully argued by Mr. Manning Dacey, but I believe that the difference is less fundamental than it might, at first sight, appear. Mr. Dacey takes the view that, since the volume of Treasury bills is now the main influence affecting the volume of bank deposits, the way to reduce the money supply is by funding; and the way to fund is to give investors a big incentive to switch from short to long securities by allowing long rates to rise while keeping short rates down.

The term funding has, however, been used by different writers to cover a number of different processes applied in various situations. It can mean a substitution, as a matter of long-term policy, of longer-term securities for Treasury bills. This is a special case (of particular importance for the banks because of their liquidity conventions) of the general process of increasing the average life, and so reducing the liquidity, of the public debt. Quite distinct from this long-term policy, however, is the short-term manipulation of the Treasury bill issue in order to reduce the banks' liquidity when it is desired to restrict credit, and to increase it when expansion is the order of the day. Finally, there is the problem of creating a situation in which the government can rely on selling, regu-

larly, at least enough market securities to cover the difference between its cash outgoings and its other sources of funds, apart from the floating debt.

There can be no disagreement about the importance of this last point. Any government that fails to maintain this degree of confidence in its securities can always be forced to add to the floating debt, and so increase the liquidity of the banking system, and can never pursue an effective monetary policy. The unwillingness of the government to accept a long-term rate at which it could sell its own securities in sufficient amounts was the main weakness of monetary policy during the 1950's. There has, however, been a marked change in the past year and, for the present at least, the outlook in this respect is much more hopeful.

It is also true that monetary policy cannot be effective if there is an excessive volume of very short-term government obligations. If the banks' liquid assets are well above their conventional requirements they cannot, without arbitrary directives, be prevented from adding to the money supply. If they have a large portfolio of very short-dated bonds it is difficult to maintain effective pressure on liquidity ratios, since bonds can always be sold with only a minor sacrifice. And if non-banking financial institutions have more highly liquid reserves than they feel they need, there will be little check on their creation of assets that, as means of holding wealth, are close substitutes for money. Despite the views of the Radcliffe Committee there has been and still is a need for a long-term policy of funding, both to reduce the volume of Treasury bills and to increase the average life of the debt.

Though the authorities have paid lip-service to funding, they have been singularly unsuccessful in achieving it. The failure has been, again, partly due to reluctance to accept a level of interest rates that is realistic in a world that is both enchanted by the glamour of growth and haunted by fears of inflation. It is also due, however, to special problems created by the war and by post-war developments in nationalization and the Welfare State. When the Conservative government took office they inherited an economy overburdened with liquidity and also with taxation; they took over commitments for current expenditure which made it hard to reduce taxes, and commitments for capital expenditure which they had difficulty in covering by sales of stock, even without any margin for funding. They would not accept a rise in interest rates sufficiently drastic to be accepted as "once and for all",

but they reacted to each bout of inflation by a moderate rise in interest rates and to each minor recession by modest reductions in taxation. This reaction was natural enough in the dilemma in which the government was placed, but it offered the bleakest possible prospect for holders of gilt-edged.

It is here that Mr. Dacey's argument seems to me both valid and very important. The volume of government debt is unprecedentally large in relation to the total value of property; the government has never, in peace-time, had such a pressing need to sell so much long-term stock; and market conditions have seldom been less favourable. It seems only natural, therefore, that the yields on government obligations, as a whole, should be historically high in relation to yields on private sector obligations (especially ordinary shares). It is equally natural, if we are to achieve any significant amount of funding, that the average yield on long-term securities should be well above the average bill rate. If this were recognized, and if monetary policy were allowed to work more freely both ways, so that investors in government stocks had some hope of capital gains as well as losses, it would go far to restore the morale of the gilt-edged market.

So far from being unusually wide, however, the gap between short and long rates over the past few years has been unusually narrow. From 1922 to 1931 the average yield on Consols was about $\frac{3}{4}$ per cent. above that on Treasury bills; during the cheap money period from 1932 to 1951 the gap ranged from 2 to 3 per cent.; for the three years 1956–58 it was only 0·1 per cent. This narrowing of the gap was, of course, the result of a long period of fairly high Bank Rates combined with the reluctance, already mentioned, to countenance a very drastic rise in the long-term gilt-edged yield. This continued closeness of short and long rates was probably an obstacle to funding and is certainly no argument for greater flexibility in Bank Rate. It does not, however, follow that short-term rates should not fluctuate more than long rates, or even that they should not rise above them in times of unusually dear money. It has been argued above that this pattern of rate movements is a natural consequence of the forces of supply and demand. It could be prevented only by deliberate action on the part of the authorities. This operation would have to take the form of aggressive sales of stock and purchases of bills, and the case for it is that it would enable the authorities to do more funding. This cannot be denied, but it can be questioned whether the extra funding that would

be achieved is necessary or whether it would be worth the price. The main incentive to go long when interest rates are high is not the current yield gap but the prospect of gaining an unusually good yield for a long time. In a gilt-edged market that could go up as well as down, fluctuations in interest rates would, without any rigging of the market, lead to variations in the volume of stock which the government could sell and so enable it to operate on the Treasury bill issue and the money supply.

A policy of low and stable short-term rates would amount to the "monetization" of a large part of the public debt. Not only Treasury bills but all the mass of short bonds in the hands of the banks, other financial institutions and the general public would become as good as money for every purpose except the actual making of payments. Comparing (in a period of credit restriction) the policy of low and stable short rates with the traditional pattern of fluctuations, the former would bring about a somewhat greater reduction of the money supply, but it would also add greatly to the liquidity of a very large volume of short-term financial assets. As an influence on the total level of demand the second effect could easily turn out to be very much stronger than the first.

Any difference of opinion that may remain between Mr. Dacey and myself seems, therefore, to boil down largely to a difference in timing. We are agreed on the importance of operating on the money supply; on the importance of funding; and on the need, in order to encourage funding, for an unusually wide gap between the average of short and long rates; and on the need for a more flexible rate policy which will allow bond prices to move upwards as well as downwards and so put new life into the gilt-edged market. Given these policies, it still seems to me that fairly wide fluctuations in short rates are both the natural free-market consequences of variations in the money stock and, through their effect on the liquidity of non-monetary assets, a powerful aid to monetary policy.

Swansea, E. Victor Morgan
May, 1961.

Peaceful Revolution in Latin America

By J. Halcro Ferguson

THE fundamental task of America's foreign aid programme in the 'sixties, President Kennedy said in commending that programme to Congress, is to demonstrate that, in the southern half of the globe as in the north, economic growth and political democracy can develop hand in hand: "Our job, in its largest sense, is to create a new partnership between the northern and southern halves of the world, to which all free nations can contribute". Within this framework, relations between the northern and southern parts of the American continent itself obviously play a key rôle.

The pronouncements both of the present régime and of its predecessor have shown a lively awareness of the magnitudes of the problems involved. During the 'fifties, the combined population of the Latin American countries rose by 30 per cent. to close on 200 millions, a level exceeding that of the United States itself. By the 'eighties the total is expected to have doubled itself again and by the end of the century to have trebled. There is a manifest danger that population growth will outstrip economic growth, so that the living standards of the individual Latin American, for so many of them desperately low, will tend to be further depressed rather than enhanced.

It is against this background that in March President Kennedy committed the U.S.A. to a ten-year plan of economic and social development for Latin America. Towards the end of May Congress passed appropriations of $500 millions of general aid, with a further $100 millions of loans to assist Chilean recovery from the 1960 earthquakes, originally requested by the Eisenhower Administration. President Kennedy's ten-year programme as a whole, an American official is reported to have said, is likely to cost some $13,000 millions.

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While the intentions of the programme must command respect, some fundamental questions are bound to present themselves to the outside observer. In particular, will the countries most in the need of aid, and most likely to benefit from it, be those which most commend themselves politically to the U.S. as recipients?—and, even if that hurdle is surmounted, are those the countries which themselves would be prepared to accept any American aid that was offered? At one end of the scale we have relatively advanced countries such as Argentina, least in need of aid but possessing régimes acceptable to American eyes. The Argentine Minister of Economy has expressed himself as hopeful that the recent negotiations will result in Argentina receiving some $400 millions of assistance. By contrast, there are Latin American countries ripe for advance, where judicious aid might well provide the impetus to rapid economic advance and social reforms; yet in the nature of the case the political and social ferment that goes with that state of affairs is unlikely to present an alluring picture to a typical Congressman. The width of the political gap to be bridged on both sides was high-lighted once again during Mr. Adlai Stevenson's recent visit to Latin American countries.

In other words, there are great dangers in implying, as the Presidential message does, that Latin America constitutes in some sense a unity, notwithstanding such concepts as the Organization of American States or the proposed Latin American Free Trade Area. Politically and economically, the twenty republics south of the Río Bravo differ from each other even more widely than, say, Holland and Albania.

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This heterogeneity will be at once apparent from even the briefest consideration of the individual States. It is instructive, for example, to start by considering Paraguay and her neighbours. Paraguay is a comparatively small country with about a million people, mostly illiterate and unable to speak anything but Guaraní, an "Indian" language understood nowhere else except in parts of Argentina. The majority of the population depends on a subsistence economy, though there is a small canning industry which, with other minor enterprises, brings in a certain amount of foreign exchange. The government is frankly dictatorial, run by General Alfredo Stroessner, the son of German immigrants. This provides perhaps the popular picture of a Latin Republic, where

nothing changes and *mañana* never comes. But now look at Paraguay's neighbours: Bolivia, Brazil and Argentina. Of these Bolivia is by far the least advanced, but things have since 1952 been changing very fast. Like Paraguay, it has a predominantly "Indian" and illiterate population, until recently mostly working as virtual serfs on bleak estates on the 13,000-foot-high *altiplano*, or as poorly-paid miners in the tin industry dominated by Patiño, Aramayo and Hochschild (the last of these an Argentine). For a hundred years after independence the country was controlled by a tiny minority of whites and mestizos (the terms denote divisions of class rather than race) and the many so-called revolutions were palace *coups* which did not alter the basic "colonial" structure of the economy.

The 1952 revolution was different. For the first time a government representing the peasants and the miners took power, the *Movimiento Nacionalista Revolucionario* (MNR), led by the economist Dr. Víctor Paz Estenssoro, who could be described as a moderate Marxist (though some of his colleagues, notably the mineworkers' leader, Juan Lechín, are considerably less moderate). The MNR government, logically and predictably, nationalized the mines, with questionable results which will be discussed later. More significantly and more unexpectedly, the peasants, under a brilliant young "Indian" leader, José Rojas, woke up after four centuries of coca-drugged apathy and despair into which the Spanish conquest had plunged them, ousted the representatives of the absentee landlords (*latifundistas*) and formed themselves into *sindicatos* or co-operatives to deal directly with the hitherto alien world of the cities.

This revolution from beneath, in a Continent where agriculture is still the principal occupation and peasants form the potential political majority, could prove just as important as anything that has happened in the rather more sophisticated setting of Castro's Cuba. At any rate it represents a startling departure from the stagnation of centuries, and in a few years has put Bolivia in a new world from Paraguay.

The United States of Brazil, nearly equal in size to the other United States and with a population approaching seventy millions, is totally different from either of the foregoing countries, even in its Portuguese language. But Brazil, like Bolivia, is undergoing a great social, economic and political revolution—though, as befits a more advanced society, by peaceful and constitutional means. It is still a country of

contrast and inequality, of sky-scraping apartment houses and *favela* shanty-towns, of booming cities and arid *sertão* back-lands; but it is booming its way into a new era in the same optimistic, disorganized fashion in which the United States spread westwards a century ago. Indeed, the westward movement—exemplified by the building of the new capital, Brasilia, in the empty centre of the State of Goias—is an important part of Brazil's current development, made possible by the aeroplane, the bulldozer and medical advances against tropical diseases.

Even more important, perhaps, has been the rise of a new and powerful middle class, which has broken both the old-fashioned socio-economic pattern of upper-class *patrão* and dependent worker and the ingrained objection of the old-time *patrão* to anything more degrading than land-owning, such as working with his hands or going into business. The new middle class, partly inspired and partly reinforced by immigration from abroad (notably Italy and, of course, Portugal), has no such inhibitions. The rise of the middle class has accompanied the beginning of a very necessary diversification and modernization of agriculture, hitherto dangerously dependent on the coffee market, and a great upsurge in industrial development, symbolized by the huge Volta Redonda steel plant. Today, Brazil produces everything from automobiles (mostly local variations of foreign vehicles) to sewing machines, and has already begun in a modest way to export her manufactured products. I give no statistics, since the latest figures published are already out of date and will be more so by the time this appears in print.

The fourth country referred to above is Argentina. To read the Argentine press one might well believe that the Argentines were living in a state of desperate austerity. Compared with the way they think they *ought* to live, no doubt they have their legitimate grouses; but they would grumble even if they had not, and in fact their standard of living would be the envy of almost any country outside North America and Western Europe.

Politically, their situation is not so happy. Though the long shadow of Perón is beginning to fade from the scene (at recent provincial and municipal elections the blank votes cast by protesting Peronistas have been steadily decreasing) there is still a depressing lack of national unity. Many trade unions still fail to see the need for retrenchment after the extravagance of the Perón era; politicians are divided on

President Frondizi's economic tie-ups with the U.S.A.; the resurgent Socialist Party looks like splitting between its right and left wings. But it is easy to overestimate the importance of such problems; they can be found a good deal nearer home and are, indeed, more akin to those facing Europe than to those confronting the other countries mentioned.

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A similar impression of great diversity emerges from a mere glance at the remaining Republics. Argentina's neighbour, tiny Uruguay, though dependent on an agricultural and stock-raising economy, has a standard of living similar to that of Argentina itself. But there are wide disparities in income between the capital, Montevideo, with a third of the country's three million people, and the "camp" which produces the bulk of the national wealth but which still operates to a great extent on a latifundist basis. Here, however, there is likely to be evolutionary change, rather than the kind of rapid transformation that has been seen in Bolivia—the Uruguayans are a more sophisticated people and their democratic institutions, based to some extent on those of Switzerland, function smoothly and effectively. Unfortunately, Uruguayan finances present a less pleasing picture: in the single year 1960 the cost of living rose by about 36 per cent.

Chile has as long a democratic tradition as Uruguay. There is still a big gap between rich and poor, and the middle class lacks both numbers and confidence. The country depends far too much on the world price of the principal export, copper; and conditions in the mines, together with inflation in the cities, have given the Communists (some of them posing as Castroites) a good deal of influence in the trade unions. Between 1953 and 1959 prices rose more than ten-fold but in 1960 the further advance in the cost of living was limited to 5 per cent.

Peru shares many of Bolivia's problems, particularly in the high sierras, where five million unàssimilated Quéchua-speaking "Indians" still live. But the coastal strip is far more highly developed, with a fast-growing middle class. The present Peruvian government of President Prado and Prime Minister Beltrán is using both local capital and foreign aid (mostly from the World Bank and the Export-Import Bank) to boost development projects like the Plan Peruvía, whose purpose is to open up the interior and set up new industries which will absorb the "Indians" into the social, economic and political

life of the nation. If, as is likely, next year's elections are won by the left-wing but anti-Castro and anti-Communist APRA Party of Víctor Raúl Haya de la Torre, this development programme may well be speeded up.

Ecuador perhaps lags behind Peru in economic evolution. It is a socially backward country, with the "Indian" element living largely outside the framework of the national socio-economic policy. Colombia depends for some 80 per cent. of its export trade on coffee, most of which goes to the United States; it is bedevilled by a geography which impedes communications, and since 1948 has been in a state of political turmoil which is only now kept in check by a delicate balance between the Conservative and Liberal parties—roughly analogous to a coalition government in a country inhabited in equal numbers by bigoted Protestants and bigoted Catholics. However, the very high calibre of the leadership of both parties gives reason for cautious optimism.

Venezuela, of course, means Oil. But the situation there is not as happy as the export figures might indicate. The popular revolution which overthrew the dictator Pérez Jiménez in 1958 completed only half of its task: while bringing in political democracy it did little to alter the social and economic structure of the country, to narrow the visibly startling gap between the very rich and the great masses of the poor, to relieve widespread unemployment in the capital, Caracas, or to improve the lot of the rural peasantry who tend—as in Peru—to come hopefully to the capital to swell the ranks of the unemployed. The Social Democratic President, Rómulo Betancourt, is a man of integrity and idealism, but he is beset by pressures from both the Right (notably the the Army) and the Left (where Communism is becoming influential). This crossfire also comes from beyond his borders: Castro has verbally chastised him for being too friendly to the United States, while agents of the Dominican Republic twice tried to assassinate him in the last years of Generalissimo Trujillo's life.

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The six Central American nations appear to some people to be largely economic colonies of the United States, the United Fruit Company of Boston having a large stake in some of them. Panama, virtually created by the United States in 1903 out of a Colombian province, and bisected by the U.S.-controlled canal, has almost no freedom of action, but

to critics of the U.S. serves as a convenient symbol of "*imperialismo yanqui*" (Peru's Haya de la Torre's suggested solution, the "interamericanization" of the canal, is totally unacceptable to the United States).

Guatemala, ever since the U.S.-backed revolution of 1954 which overthrew the elected but leftist President Arbenz, has been politically aligned to the United States, to the extent of allowing its territory to be used for the training of the exiles who unsuccessfully invaded Cuba earlier this year. Internally, however, it is another matter. The reforms brought in by the Arévalo and Arbenz régimes, Communist-tinged and repugnant to both President Ydígoras and to U.S. business though some of them may be, cannot now be scrapped. This is particularly true of the replacement of the *patrón* father-figure by labour unions and by what the Russians would call rural soviets. This has changed the ordinary man's whole conception of his economic worth and his place in the social structure, a change of attitude whose results are as fascinating and incalculable as those of the Cuban or Bolivian Revolutions—or the Mexican Revolution of 1910, a turning point in the history of the Americas to which I shall return later.

Of the Central American countries little Costa Rica is by far the most advanced. It is a kind of Central American Denmark, and its capital, San José, has an almost Copenhagen quality—very clean and courteous and full of bookshops. Costa Rica has no army, more teachers than policemen, a high rate of literacy, and no real socio-racial problems: the "Indians" are assimilated, the coastal Negroes (who speak West Indian English at home and have names like Graham) accepted, and almost nobody is ostentatiously rich or shamefully poor. Government is polite and very parliamentary.

Next-door Nicaragua, on the other hand, is the nicest feudal monarchy I know of. Most of it is owned, and all of it is run, by two brothers called Somoza, one of whom is President and the other the head of the armed forces. Their father, who was unfortunately assassinated, held both posts, and the family property, before them. On the surface all this seems very cosy, but among the working classes there is an almost universal admiration for Fidel Castro, usually (outside Cuba) the sign of a dissatisfied people. El Salvador, a coffee-growing country of small proprietors, is at present being run by the Army, largely for reasons too parochial to detail here, though pro- and anti-Castro feelings played their part. Honduras—not to be confused with British Honduras across

the bay—is backward but currently democratic. It plays little part in inter-American or international affairs.

To the north Mexico, with a population of about thirty millions, does play such a part. It was the first Latin American (or, as many Mexicans and Peru's APRA party say, Indo-American) country to follow up the political declaration of independence in 1810 by an economic declaration of rights exactly a hundred years later. Mexicans delight in telling Russians that they beat them to the post with a revolution of workers and peasants by seven years. That is true, but the revolution was not consolidated until the nineteen thirties, since when it has been upheld by the Institutional Revolutionary Party (P.R.I.). There the parallel ends. Mexico is not, in the sense used either by the Americans or the Russians, a Communist country. It is not even, in some ways, a socialist one. Its economy is mixed: basic industries—such as oil, railways, and public utilities—are nationalized, but private foreign capitalist investment is encouraged. Land has been parcelled out into *ejidos*, or peasant holdings, and *ejido* banks give loans and help the farmers to act co-operatively, but there is still a lot of private property.

The PRI has been running the country for as long as anyone can remember, but there are regular elections and opposition parties. Most of the latter represent such sectional interests that they haven't a chance, but the threat to the Establishment (whose incumbent is subject to constant advice from living ex-Presidents) is less from opposition parties than from young PRI members, who feel the PRI is becoming steadily more Institutional and less Revolutionary, and who privately yearn for the more dramatic activity of Fidel Castro.

* * *

Thus we come at last to the independent Caribbean islands, Cuba, Haiti and the Dominican Republic (not of course to be confused with the inoffensive territory of the West Indian Federation called Dominica, which carries the stress on its penultimate syllable, in a French accent).

The Dominican Republic, formerly the Spanish colony of Santo Domingo, occupied by neighbouring Haiti during the last century, reoccupied later by Spain, and occupied yet again by the United States, has had an unhappy national existence. This led it to accept the rule of Generalissimo Trujillo in 1930 because at least it promised stability. Stability was what the so-called Benefactor gave it, at the cost of human rights:

anyone who opposed the dictator was likely to come to an untimely end. But it cannot be denied that, like Salazar in Portugal, Trujillo brought relative domestic peace. He also, until the last years, balanced his budget and maintained a comfortable trade in sugar and other products with—among others—the United Kingdom, towards which he always expressed the most amiable sentiments.

Now he has gone, and the future is unpredictable. What is certain is that the Dominican Republic, which has been pickled in paternal brine for over thirty years, will not remain forever impervious to the cold and hot winds blowing in from the outside. And that is true even of Haïti, the odd-man-out of all the twenty Republics.

Poor Haiti. It was by six years the first Latin American country to achieve its independence, in 1804, when a slave revolt ousted the French and made this half-an-island, until then Saint-Domingue, the first black Republic in the world. Haiti was born in blood and glory and brilliance and lunacy; its founders numbered such colourful figures as Toussaint l'Ouverture, the Emperor Henry (*sic*) Cristophe, Dessalines, Pétion, Boyer. Today, with its breathtaking scenery and its charming people, Haiti is a tropical, rural, undeniable slum. Ninety per cent. of its estimated four million people are illiterate, nearly all are poor, most are sick and they live by subsistence farming. A small coffee-coloured *élite* lives comparatively well, sends its children to the Sorbonne and reads Baudelaire and Racine. There is a rum distillery but little other industry. There are few paved roads. Imports and exports are on about the same scale as those of Paraguay: about $30–40 millions a year each.

Which (leaving aside the question of why Haiti should have been so much less successful than subsequent Negro nations) brings us to Cuba. This is, of course, the test case for the whole question of future relations between the United States and her neighbours to the south. The problems of that relationship are high-lighted by the implacable hostility between America and the Castro régime. That antagonism goes deeper than any ordinary disagreement between a huge country and a comparatively small one, between a so-called Latin and a so-called Anglo-Saxon one, or even (though this is enormously important) between antagonists in the so-called cold war. And the tragedy of it is that both the leaders involved, Castro and Kennedy, sincerely believe they are on the side of the angels and, what is more, sincerely believe

that their policies are for the benefit of the rest of the Americas. Yet they are not even near to speaking the same language. How has this come about, and what is going to be the result of their parallel but hostile efforts to achieve their almost identical goals of an increased standard of living and a greater measure of equality of wealth and opportunity?

* * *

Before going into this, one must take into account what the fundamental problems of Latin America, hinted at in this swift survey, actually are. For that purpose, as has been suggested earlier, it is necessary to divide Latin America into three distinct groups of countries.

First, there are the more highly evolved societies with more or less integrated if not homogeneous populations and a relatively high standard of living, even though this is not in some cases as evenly spread as it should be. This group comprises Argentina, Uruguay, Brazil, Costa Rica, and—with important reservations—Mexico and Chile. These societies are characterized by a large or at any rate growing middle class, a large or rapidly increasing percentage of literacy, a measure of industrialization in most cases and relatively stable political institutions. None of these countries has yet realized the full potential of its natural and human resources, and to that extent they can be classified as under-developed; but they are in no sense backward. And, whatever their problems of shortage of capital, balance of payments, inflation and so on, their basic structure is sufficiently sound to ensure the evolutionary nature of their progress. They can be counted upon to act responsibly and reasonably predictably.

The second group consists of countries which are at this moment going through rapid social, political and economic changes, either peacefully or not, but which lack the resilience of societies like the Brazilian to cushion the shock of change and which in general lack also the trained and educated personnel the first group possesses. This second group is a heterogeneous one consisting of Peru, Bolivia, Ecuador, Colombia, Venezuela, Cuba and, marginally, Guatemala. It is possible it will be joined soon by the Dominican Republic.

It is characterized by these features: the division of the population into a small *élite* group, often highly sophisticated but usually without any technological knowledge, and a great mass of unskilled and illiterate peasants or recent town-dwellers; the existence at the same time of a strong socio-

economic ferment which is bound radically to alter the existing social and economic order, as it already has done in Cuba; and, finally, an undue dependence on the export of certain staple products and the import of many basic necessities, coupled with a strong desire to break this stranglehold.

This group is by far the most inflammable, and of its components Cuba has already gone up in flames. It is here that aid is most needed to tide the countries over what amounts to the second Latin American war of liberation. Political emancipation was achieved over a century ago but the war for social and economic emancipation is being fought now. Seen, as it is from Washington, in terms of the cold war, the need for assistance is here the most pressing, though if Marx had never been born there would still be a strong case for assisting the orderly transition of these territories into twentieth-century society.

Finally, there is the last group, which might be described as "the unawakened". This consists of Paraguay, Haiti, Honduras, Nicaragua and El Salvador. All these are small countries, either dependent on a single crop (coffee or bananas) and a single market (the United States) or else, as in the case of Haiti, existing precariously on a subsistence economy. Most of them are dominated by a single strong man, family or oligarchy.

Except for Haiti, whose evident poverty shocks the most insensitive, there might seem a case to the superficial observer for leaving these countries as they are, with their fiestas and siestas, their picturesque landscapes, and their sleepy suggestion of *mañana*. But though this may be all very well for the tourist, it does not satisfy the inhabitants, who would —especially among the young—trade all the picturesqueness in the world for a higher standard of living. It is significant that in all these countries Fidel Castro makes an enormous emotional impact, even though their citizens often do not know what precisely he stands for (a good many Cubans don't either, for that matter, and one sometimes doubts if he does himself).

These countries in fact form a substratum of the second group, which they are certain to join within the foreseeable future, and it might be well to do something about them while they are still in a quiescent state.

* * *

The two channels through which Latin America can

acquire the capital necessary to the full exploitation of her resources are, on the one hand, private investment by overseas firms and, on the other, grants or loans from foreign governments or international agencies. The first source is of course the traditional one and provided the bulk of capital investment from the early days of independence up to the second world war.

Among the investing countries Britain was long predominant. In Argentina she financed the "big five" railways, the Buenos Aires tramway system, the Primitiva Gas Company, the Anglo meat-packing and freezing plant, and also invested in land for stock-raising, such as the Bovril estancias. British capital built up similar enterprises in Uruguay, plus a motor-tyre factory. In Chile the nitrate industry (later to lose its importance with the development of artificial substitutes) was British-financed, as was the Antofagasta and Bolivia Railway. In Brazil the internal telegraph system was pioneered by British interests. The department stores of Harrods, Maples and Gath y Chaves in Buenos Aires were all British-founded, and of course the bulk of Latin America's import and export trade was carried in British bottoms. In 1910 British capital investment in Argentina alone was estimated at £291 millions.

Between the wars the ratio of British investment to that of other overseas countries decreased, with the rise of the industrial potential of, in particular, the United States and Germany. The United States initially invested most heavily in citrus fruits and bananas, later in oil, and has now branched out into almost every field of enterprise. Germany, which started by the simple export of consumer goods, e.g. pharmaceutical products, later went on to invest in Latin American industry and to provide capital equipment. After losing contact completely during the second world war she made an astonishing recovery and now has large interests, particularly in Argentina and Brazil. Since the war Japan has entered the field, and Japanese firms have set up factories in Argentina and are providing rolling stock for Peruvian railways.

Many of Britain's long-standing interests were, as has been shown, in public services like transport and power. Most of these have now, in accordance with a world-wide trend, been nationalized, and this has perhaps given British businessmen a sense of insecurity. At any rate, since the war there has been a marked reluctance to put money into Latin America, which contrasts with the eagerness to invest in other (and in

the Latin American view) sometimes more risky markets.

This, it seems to me, in so far as the first and more developed group of Latin American countries is concerned, is a misreading of the situation. The most respectable Western European countries have pursued a similar policy for their public service industries and, while this might appear "socialistic" and dangerous to the North Americans, it should not worry anyone here. Most of these industries had repaid the original investment many times over, but when they were taken over the transport services in particular were in poor condition and running at a loss. The Argentine government, indeed, probably paid more for the railways than they were worth, though it was to the interest of both parties to pretend otherwise.

Nevertheless, the fact remains that the day for this particular kind of private investment is over. Especially in the major countries, however, there is and will continue to be a demand for other types of investment—notably the provision of capital equipment in Latin American industry—and for the partial financing of mixed local-foreign concerns. The Americans, the French and the Germans, for instance, are all participating in the Brazilian and Argentine automobile industries, to the profit of all concerned, and these hard-headed people are not likely to put their money into shaky concerns.

British businessmen tend to explain their caution about Latin America, when they explain it at all, by saying they prefer to keep to traditional markets or that the political situation in Latin America deters them. But Latin America *is* a traditional British market, and at the moment has no monopoly of political troubles. In fact, it offers a wide choice of opportunity outside the public utility field. But this, however satisfactory from the overseas investor's point of view, does not of course go anywhere near answering Latin America's need for capital investment. Private firms, however large, just do not have the resources. Massive and co-ordinated assistance can be forthcoming only at government level; and the only government in a position to supply it, apart from the Soviet Union, is the United States, whether in the form of direct grants or loans or channelled through international agencies like the World Bank.

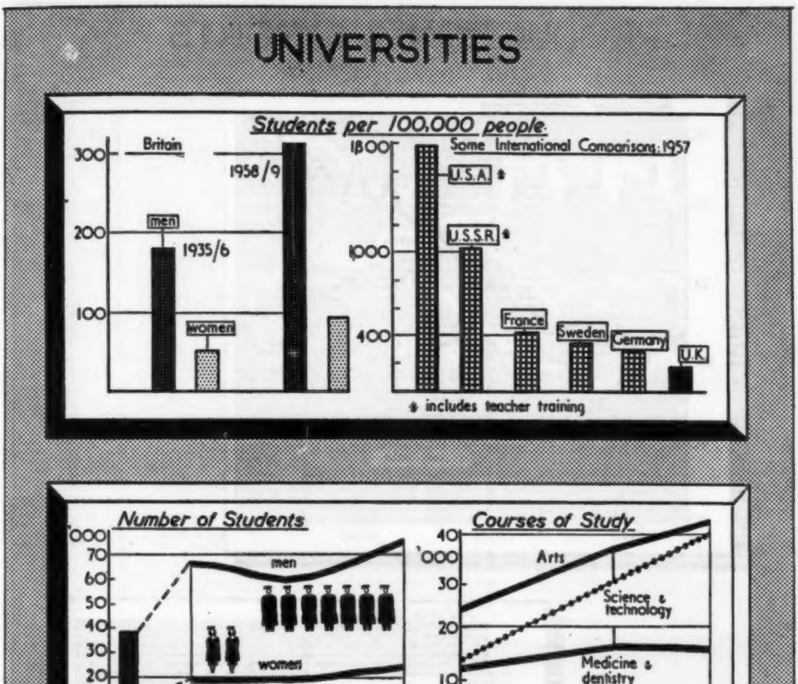
And here comes the real dilemma facing both the United States and the Latin American countries. However willing many practical-minded Latin American governments may be

to accept outright assistance, even with strings, from the United States, they know that it would be political suicide to do anything so simple. In the public mind in these countries, the United States, whatever "revolutionary" image Mr. Kennedy may have of his country, is associated with reaction, with everything that the people of Latin America are now revolting against. They have seen U.S. ambassadors and businessmen hobnobbing with dictators and absentee landlords; they have seen U.S. funds used to equip repressive police forces; they have in many cases had the experience of being occupied by U.S. marines; they have heard of U.S. aid in overthrowing an elected Guatemalan government and more recently U.S. complicity in the abortive invasion of Cuba. All this makes Mr. Kennedy's offer of $500 millions under the title of *Alianza para Progreso* seem at best suspect and at worst Machiavellian.

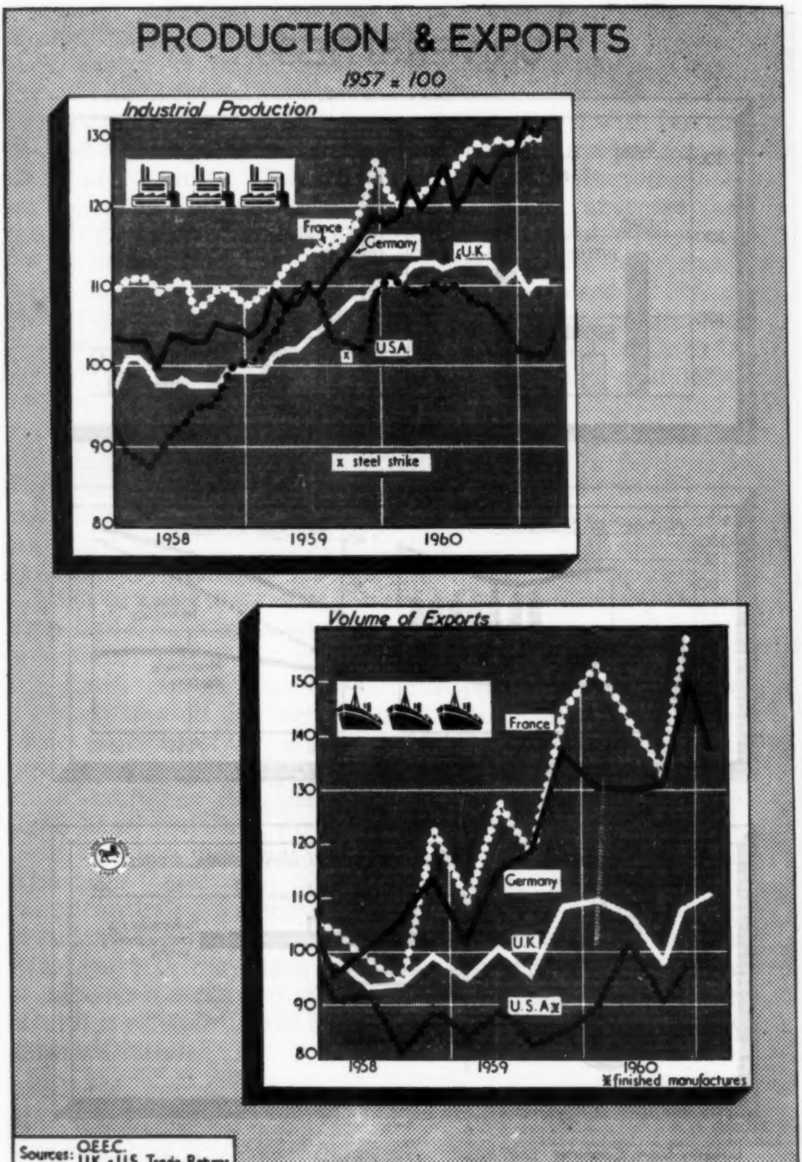
In a book published recently for the U.S. Council for Foreign Relations (*Social Change in Latin America Today*, Harper & Bros., New York), it is pointed out by an American professor that the capitalist United States is in the curious situation of finding it necessary to support the emergence of what is virtually a socialist society in Latin America if she is to keep Latin America friendly and prevent the spread of Communism.

Latin Americans know, Europeans know, and Mr. Kennedy himself doubtless knows, that socialism, in the sense of Social Democracy, is very different from Communism and often totally opposed to it, and that even Marxism may be anti-Communist (e.g. APRA). But the great bulk of North Americans, including apparently most members of Congress, have not yet grasped this vital point. To them, Peruvian Apristas, Venezuelan Social Democrats and other Latin American leftist parties are just as "Red" as Mr. Khruschev. President Kennedy, in fact, when it comes to channelling American aid, may have as hard a time persuading Congress to allocate it as in persuading the recipients to accept it in the form it is offered. It will be one of the trickiest tasks facing his Administration.

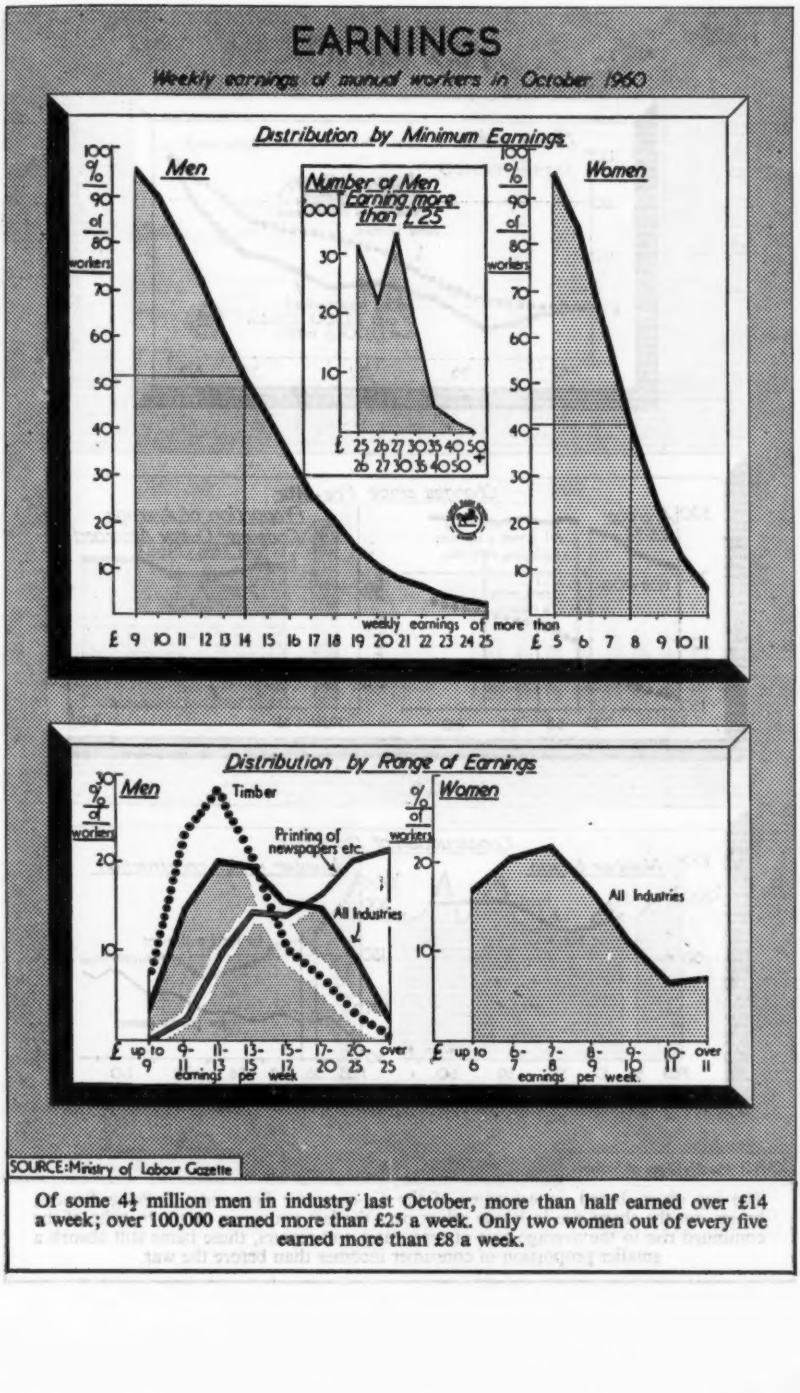
London,
June, 1961. J. Halcro Ferguson



Relative to population, considerably fewer young people in Britain attend colleges and universities than in many other countries. Over three-quarters of our students now receive assistance of some kind, against less than a half twenty-five years ago.

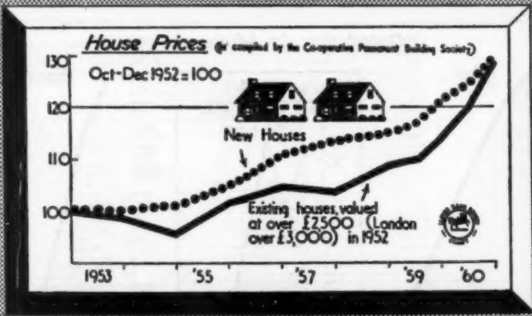


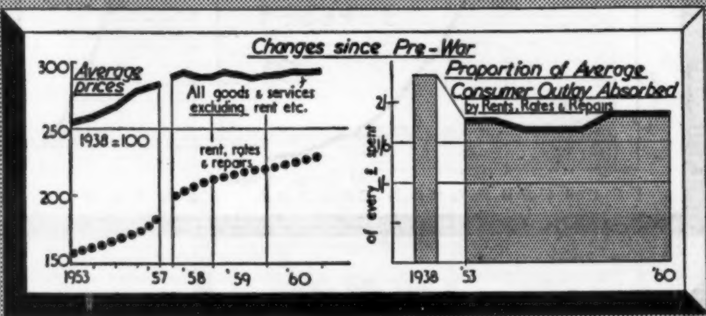
While production in Britain now shows signs of moving off the plateau it reached early last year, in the U.S. output is clearly rising once again. Both production and exports of most Continental countries continue to forge ahead.

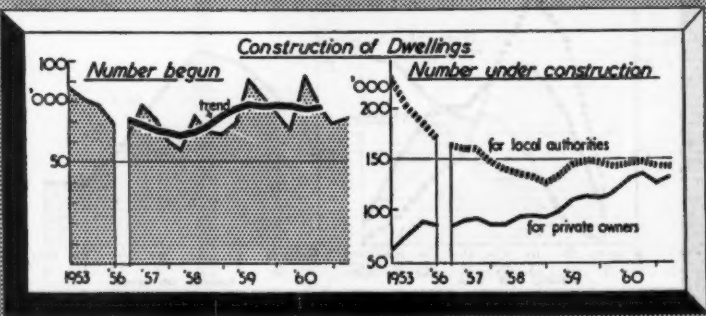


Of some 4½ million men in industry last October, more than half earned over £14 a week; over 100,000 earned more than £25 a week. Only two women out of every five earned more than £8 a week.

HOUSING

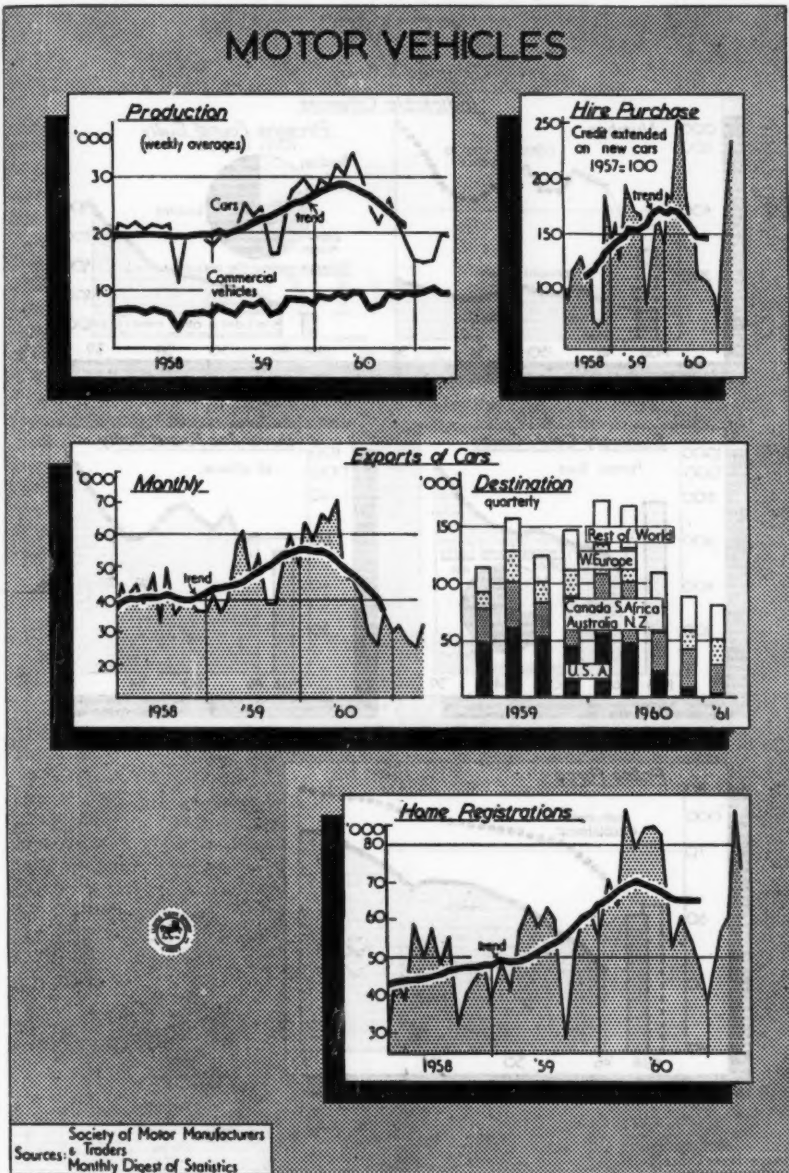




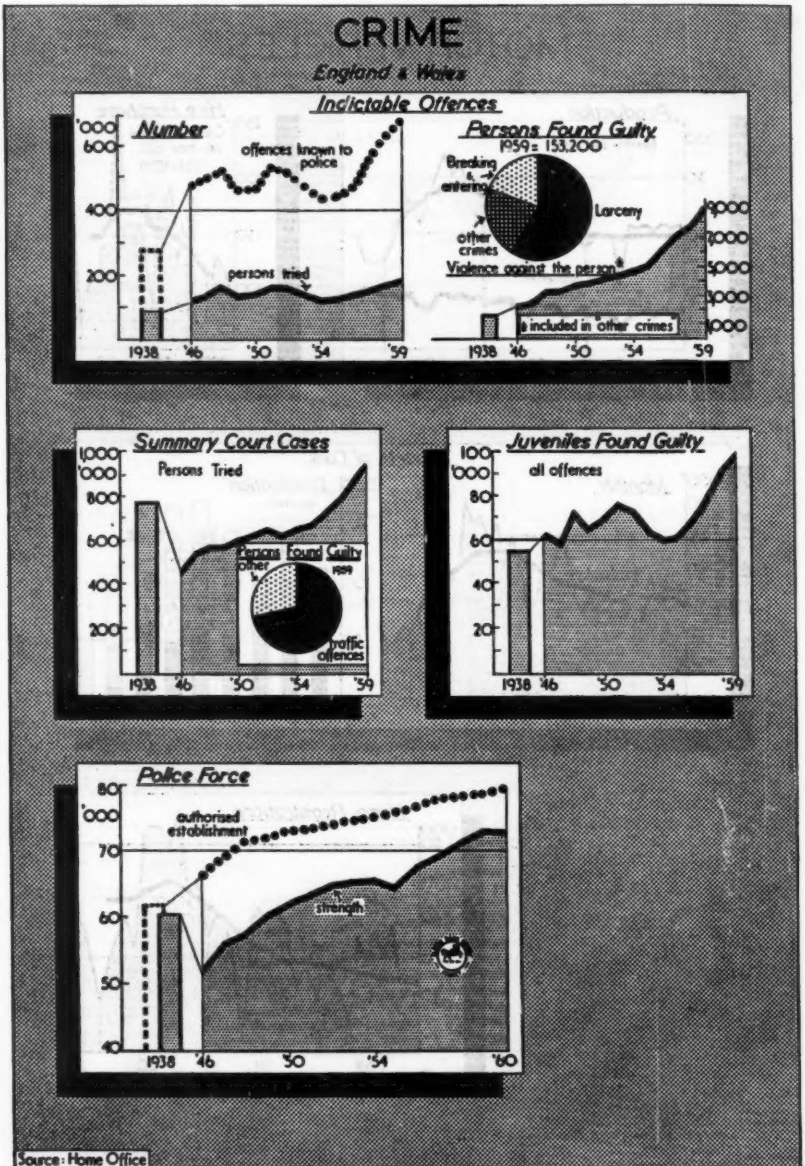


SOURCE: Monthly Digest of Statistics

The top chart, based on estimates of the *Co-operative Permanent Building Society*, brings out the sharp rise in house prices over the last two years or so. In spite of the continued rise in the average cost of rent, rates and repairs, these items still absorb a smaller proportion of consumer incomes than before the war.



Car production now appears to be picking up again, with h.p. sales also showing some improvement. Exports, however, remain somewhat sluggish. About half the reduction between the first and second halves of 1960 in the number of cars exported was due to the contraction in the American market.



Between 1954 and 1959 indictable offences known to the police increased by over 50 per cent., while the number of cases proved of violence against the person almost doubled. Two-thirds more young people under 17 years were found guilty (of all offences) than in 1954.

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